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PRIVATIZATION OF THE FEDERAL GOVERNMENT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON
MONETARY AND FISCAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE
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PRIVATIZATION OF THE FEDERAL GOVERNMENT

THURSDAY, SEPTEMBER 27, 1984

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY AND FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:50 a.m., in room SD-628, Dirksen Senate Office Building, Hon. Steven D. Symms (chairman of the subcommittee) presiding.

Present: Senator Symms.

Also present: Steve Hanke, professional staff member.

OPENING STATEMENT OF SENATOR SYMMS, CHAIRMAN

Senator SYMMS. Good morning. We call the meeting to order.

This is the fourth in a series of hearings on privatization before the Joint Economic Committee's Subcommittee on Monetary and Fiscal Policy.

Privatization is the transfer of the ownership of assets and, consequently, the responsibility for supplying goods and services from the public to the private sector of the economy.

Today we will address the privatization of public housing. I am particularly pleased that Congressman Kemp will be here to testify today. He will not be our first witness because of an airline delay, but he will be here soon to testify on the privatization of public housing, which is not the only privatization issue. It is also a supply-side issue, one that is of importance to the future growth of our Nation's cities.

Government intervention has driven a wedge between the demand for and supply of housing in this country. As a result, these Government policies actually work on the supply side of the housing market to either destroy our Nation's housing stock or retard its growth. Prof. Peter Salins has documented how these negative supply-side effects have worked in New York City. For evidence, allow me to suggest that you refer to Salin's book, "The Ecology of Housing Destruction."

By privatizing public housing, I believe we can begin to remove some of the supply-side impediments to the provision of housing for the needy.

As I said, Congressman Kemp will be here to give an analysis of the privatization option for the United States. But we will first hear from Mr. Stuart Butler, who will review how Britain's privat-

ization program for public housing has worked. So we will switch the order of testimony this morning.

Now Mr. Stuart Butler is in the room, I believe. Will you come up, Mr. Butler, and sit down; and I might just apologize in advance. I have not had the opportunity to talk to Congressman Kemp this morning. I don't know what his schedule is and I might ask you what is your schedule; are you free here between now and noon?

Mr. BUTLER. Yes, I am.

Senator SYMMS. So when Congressman Kemp gets here we may ask him to join you and make his statement and his testimony if he's under time constraints and has to return to the House. I know he is busy at the close of the session.

So, Mr. Butler, we welcome you here to the committee. This is an issue that I think is of great interest to all of us. I think it provides a great opportunity for people who are presently disadvantaged to be able to proceed forward and eventually have more private ownership in the country. Ultimately some of those places will be owned by the tenants themselves. I think it would be a wonderful opportunity.

But what we would like to do is hear from you now. You represent the very prestigious Heritage Foundation. We are happy to have you here to testify and tell us what's happened in the British experience with respect to privatization of public housing. So please proceed.

STATEMENT OF STUART M. BUTLER, DIRECTOR, DOMESTIC POLICY STUDIES, HERITAGE FOUNDATION, WASHINGTON, DC

Mr. BUTLER. Thank you very much, Mr. Chairman.

Let me say at the outset that I'm very pleased that these hearings are taking place. I think that the issue of privatization is a long overdue item on the political agenda and it also is very important to concentrate on issues like public housing and to begin to move the emphasis a little bit away from seeing privatization as purely contracting out services and to look more explicitly at the idea of transference of ownership—which is really, as you said, the key to privatization. By changing the ownership structure of an asset you can have very important effects on the way that such asset is treated and the kinds of effect it has for the economy and the manner in which it is kept up.

It's very clear, as you also said, that when people have a direct equity stake in their homes they do behave very differently, and the key to urban development, as Congessman Kemp no doubt will emphasize, is that by having control and ownership one sees different behavior patterns within the inner cities leading to improvement based on a direct state in the future of the residence.

I think it's also important when one is talking about assets to remove one misunderstanding that often accompanies discussion of privatization, and that is the idea that by transferring assets out of the public sector—out of the Federal control, and doing so in some cases at a discount—that this means that the taxpayer or the Federal Government is losing and that it is some kind of giveaway.

Yet, quite the opposite is the case. We find, particularly in cases like public housing but also in other Federal assets, that the

present Federal ownership has led to deterioration of those assets and in many cases a negative cash flow on those assets.

Senator SYMMS. That's exactly what's happening in the national forests in the West.

Mr. BUTLER. That's absolutely correct.

That's indeed the case and indeed I would just say as a footnote there that when the idea of public housing privatization was first discussed in Britain, in fact the first proposal was to give it away. The issue was very clear that one was giving away a lasting asset and leading to the improvement of that asset in private ownership. So, as you said, I think it's very important to appreciate that we are talking about assets that at the moment are losing money to the Federal Government and by transferring them one is talking about improving the budget situation and not reducing it.

But also, of course, in the case of public housing it is very important to note that the object of privatization in these cases is not really a budgetary goal—that's a very minor goal—but it is to improve the fabric of the neighborhood, to improve the conditions within those neighborhoods.

Let me just first discuss the British plan and then note some of the implications of this plan for the idea of privatization in this country.

The so-called Right To Buy plan for public housing ownership in Britain really began in the early 1970's with a law passed under the administration of Edward Heath which permitted local authorities to sell public housing at a substantial discount to the tenants within those units. This was, as I said, a permissive law. It meant that the equivalent of Public Housing Authorities in Britain could sell those units. It did not require them in any way to sell those units.

A second law passed under the administration of Margaret Thatcher, made this a mandatory sale. In other words, if a tenant requested to purchase his or her unit from the local government, the local government authority had to sell that unit. It's a very important distinction in the strategy of privatization.

Let me just run through some of the elements of the British plan just to point out how it applies and then discuss some of the differences.

In the British plan, the initial eligibility is that a tenant has to have been a resident of public housing, not necessarily the unit in which he now resides, for a minimum of 2 years. He can then purchase under certain conditions. He may also, incidentally, purchase jointly with other members of his family that have been in the unit for at least 3 months.

This is a very important aspect of the British plan because what it means is that older tenants, in some cases retired members of the community, can actually buy their units with the assistance of other members of their family. And that has been an important element of the British plan. It is not a plan that only means that blue collar workers or people with a solid income can purchase; it also means that those that have been in the unit for many years have an opportunity to purchase.

If the tenant has been a resident of public housing for 3 years, he is permitted to purchase the unit at a 33 percent discount on the

market price of the unit. The discount increases in increments of 1 percent for each additional year that the tenant has been in public housing. As I emphasized, this is not necessarily the unit which he wishes to purchase.

So that the maximum, after 30 years, is a 60 percent discount that can be applied to the sale price, a very significant reduction, in other words, in the market price of the unit.

With regard to finance, two possibilities are open to the tenant. He can either seek traditional mortgage in the private sector, and about half of all units sold in Britain are financed with private sector mortgages, or he has the right under the right to buy plan to approach the local authority, equivalent to the Public Housing Authority, and that authority must provide him with a mortgage which is approximately the same as that of the private sector. In other words, there is not any major discount on the mortgage.

He may also take the option of buying in segments, 12.5 percent segments. In other words, he can build up his equity in the house over a period of years by purchasing new segments as his income permits.

In addition, under a very special provision of the tax code in Britain, a measure has been introduced to provide low-income buyers in public housing and other types of housing with the equivalent of a mortgage interest deduction. Under the so-called Mortgage Interest Relief at Source program in Britain, a deduction in interest rate is permitted for people with lower income levels.

In other words, some kind of mortgage relief is available even for those people who are not at higher ends of the tax bracket.

A final provision which is very important is the so-called value recapture provision in Britain. Clearly, if you have a program which gives a substantial discount on the sale price, there is always the danger that the buyer will merely turn around the property very quickly and enjoy the discount and obtain market price and disappear. Well, under the British plan, there is a gradual phase-out of the recapture provision over 5 years. If the buyer sells his property in the first year, all the discount is repayable to the seller—that is the local authority. If he sells between 1 year, and 2 years, then 20 percent of the discount is returnable to the seller and so forth. After 5 years, he can enjoy a complete discount if he sells the unit. In other words, there is a provision in the British plan that does mean that the discount is recaptured gradually over a period.

Under the British plan, well over 500,000 units have been sold since Margaret Thatcher took office. Moreover, it's an interesting point to note that resistance to the plan has proved politically very difficult. The initial program that I mentioned passed in the early 1970's and permitted local authorities to sell units but, of course, in many cases, sometimes for political reasons and sometimes simply because of various local considerations and contracts that were applicable to public housing, there was resistance among local authorities to actually sell to their tenants, despite the enthusiasm of the tenants for the program.

When the Right To Buy Program was set in motion in the late 1970's and 1980's giving the tenants the right to buy——

Senator SYMMS. Where did that resistance come from? Where was the resistance to selling?

Mr. BUTLER. There were really two elements of resistance. One was simply political opposition from the local authorities—city councils which just disagreed with the concept of transferring ownership to the private sector. They believed that public housing ought to be a form of social service in the community, so there was that political opposition. Second, from those private institutions and other organizations that provided services and maintenance and so forth for those houses. There was resistance there to it, primarily political.

Senator SYMMS. How about the economic arguments that were used that they were disposing of valuable assets?

Mr. BUTLER. Outside the political aspects, that really was not a very strong argument. It was initially thought that it might be a problem, particularly, of course, with low income working class people who purchased their own homes in the private sector. It was thought that people with very similar incomes to theirs would be purchasing public housing, but in fact that didn't turn out to be the case. What one generally found was that those citizens that had privately purchased housing near to public housing projects felt that my transferring the public housing projects to the private sector, to the tenants, that would in fact enhance the general value of properties in the neighborhood and I think that's a very, very important point, both politically in terms of reducing opposition, but also the point that when you transfer the ownership of public housing to the tenants you do have an effect outside those units themselves. You have a general effect on the neighborhood and you have an effect on the stability of the general neighborhood and therefore the rentability of other units in the project. So that spillover effect is very, very important and did diffuse a lot of the opposition.

Senator SYMMS. Mr. Butler, are you at a good breaking point?

Mr. BUTLER. That pretty well sums up my points about the British plan.

[The prepared statement of Mr. Butler, along with an attachment, follows:]

PREPARED STATEMENT OF STUART M. BUTLER

My name is Stuart Butler. I am Director of Domestic Policy Studies at The Heritage Foundation. The views I put forward are my own, and should not be taken as representing any official position of the Foundation.

I have taken a keen interest in the idea of privatization for some time, and a number of articles by myself and other authors on the issue have been published by Heritage during the last three years. These have dealt with a wide variety of issues from the privatization standpoint, including Social Security, municipal services, bank deposit insurance, and, most recently, public housing. My interest in the idea of privatizing public housing stemmed from the work of the National Center for Neighborhood Enterprise, and from the experience of a privatization model in Britain.

The National Center has examined the role of neighborhood-based organizations in service delivery and economic development within low income communities. The Center found that when groups are given control of functions, they can be remarkably successful in bringing down costs and developing innovative and highly effective methods of dealing with local problems.

Housing is a case in point. In conjunction with the Project on Neighborhood Revitalization of the American Enterprise Institute, the National Center has examined the performance of community-based management organizations as operators of public housing -- Kimi Gray, the Resident Manager of such a corporation in Washington, will be testifying before the subcommittee

tomorrow. The data concerning these corporations will be discussed during Ms. Gray's testimony, but the general conclusion is that dramatic cost reductions can be achieved once tenants obtain control of their own housing destiny.

Ownership is the logical next step after tenant management. Ownership provides a clear stake in the community -- one that is permanent. The evidence from both the United States and Britain is that once low income people acquire ownership rights over their homes, they take a very different view towards maintenance, economic improvement, and even social problems within their community.

It is this change in attitudes and commitment that lies at the heart of the privatization strategy. Privatization has nothing to do with "selling off" valuable federal assets to private interests: it has everything to do with using a change of ownership to alter behavior patterns, thereby stimulating efficiency, innovation, and a determination to preserve and improve the asset. The proposal to encourage homeownership among public housing tenants is an excellent example of this strategy. By providing residents with an ownership stake in their communities, the program would enable low income people to attain the American dream of home ownership, reduce the burden on the federal government of excessive operating costs, and stimulate community efforts to tackle the social problems that now lead to falling property values, vandalism and boarded-up dwellings.

Following is an analysis of the British "Right to Buy" program, which has turned 500,000 tenants into homeowners,

together with the framework of a plan for a similar program in the United States. While there may be disagreement on the details of such a homeownership plan, there can be little doubt that the ownership idea works in low income neighborhoods. The demonstration program being developed by HUD is a major step forward in turning ownership into a reality in such neighborhoods. I hope that Congress will study that program carefully, while preparing the legislation necessary to turn the experiment into a full program.

The Heritage Foundation Backgrounder

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June 12, 1984

PUBLIC HOUSING: FROM TENANTS TO HOMEOWNERS

INTRODUCTION

Public housing projects in the United States have come to epitomize urban blight. While this view is exaggerated, it is nevertheless true that public housing represents one of the great ironies of federal intervention. When the program began in the 1930s, the assumption was that the projects would help ameliorate social problems in the cities by stabilizing communities and the housing stock. The reverse has been true.

Yet there is evidence, in this country and abroad, that certain inner city housing experiments can have positive results. They all have one thing in common--ownership. Whether the program is homesteading, where abandoned properties can be bought for a dollar, or the discounted sale of public housing to tenants (in Britain), the effect is the same. When residents acquire an equity stake in the future of their building, and hence their neighborhood, they gain incentives to change their behavior from destructive to constructive and to urge their neighbors to do likewise. And instead of economic improvement bringing with it the threat of increased land values and displacement, equity allows a resident to rise with the tide--not drown in it.

But, some would argue, the low income of public housing tenants precludes their becoming homeowners. The solution to this apparent barrier is to recognize that support for homeownership is entrenched in the tax codes. Thanks to the mortgage interest deduction, middle- and upper-income Americans have powerful tax incentives to become homeowners. This is no accident. The explicit purpose of the deduction is to help Americans purchase homes. Yet the low-income tenant, who pays little or no income tax, has no such incentive--so he must pay a far higher after-tax price than higher-income citizens buying exactly the same property.

Note: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

Congress and the Administration should recognize this inequity and establish a "Right to Buy" homeownership program in the inner cities, based on the sale of public housing buildings, at a substantial discount, to associations of occupying tenants. The Reagan Administration should establish an experimental program immediately using existing law. It should also seek legislation to permit tenant associations to apply directly to the Secretary of Housing and Urban Development (HUD) for permission to purchase buildings from their local Public Housing Authority (PHA). The legislation should also allow the Secretary to require the PHA to provide the tenant group with a mortgage.

Proponents of such a program would be blind if they overlooked its political advantages. A similar plan in Britain enabled Conservative Margaret Thatcher to make considerable inroads among traditionally Labor-voting public housing tenants in her landslide 1983 reelection. The New York Times noted after the election that:

> As political experts and party strategists sift through the results of Labor's crushing defeat...more and more are identifying the "homeowner mentality" of voters...as a crucial development.[1]

An inner city homeownership plan would extend the idea of owning a home to low-income Americans. It would help stabilize the value of public rental stock near tenant-owned units, and would plant the seeds of improvement in the nation's most desolate neighborhoods. It would be a logical companion to the enterprise zone approach to inner city development. Like the zone proposal, which seeks to unlock the entrepreneurial spirit, the Right to Buy program would draw on the strengths of residents to tackle the problems of their own community.

THE BRITISH RIGHT TO BUY PROGRAM

During the last five years, over 500,000 dwellings (out of a total public housing stock of approximately 7 million units) have been sold to public housing tenants in Britain under the "Right to Buy" scheme. Widening homeownership in this way is seen by the Thatcher government as central to its objective of reviving neighborhoods and encouraging self-improvement.

Stated simply, Britain's Right to Buy program allows public housing tenants to purchase their units at a discount on the market value of up to 60 percent, based on the length of tenancy.

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[1] "In Housing Policy, It Seems the Tories Had a Winner," The New York Times, June 22, 1983.

1) Eligibility

A tenant obtains the right to buy if he or she has been a public housing tenant for at least two years[2] and the unit is the principal home. The tenant can purchase the unit jointly with up to three other family members, provided they have been living in the same unit for at least three months.

2) Discount

If the tenant has lived in public housing for three years, the unit can be bought at the market value less 33 percent. The discount increases by 1 percent for each additional year as a tenant, up to a maximum 60 percent discount after 30 years as a tenant.[3] The period counting toward the discount need not have been spent in the same unit, or even within the jurisdiction of the same housing authority. The valuation, upon which the discounted price is based, is calculated by the housing authority. If the tenant disagrees with that valuation, he can appeal to the District Valuer, an independent official whose decision is legally binding on both parties.

3) Finance

The purchaser has three options in raising the money to pay for the house.

a) The tenant can obtain a mortgage from a savings and loan association. Approximately half of all public housing sales are financed in this way.

b) The tenant has the legal right to a mortgage from the local housing authority. Basically the loan amount is limited to 2½ times the annual income of the purchaser, plus 1 times the annual income of any other family members assisting in the purchase. For purchasers over 60 years of age, the multiple is lower.

c) The tenant may buy the unit in stages. After buying at least 50 percent of the unit, with the usual discount according to length of tenancy, he can obtain full ownership by purchasing increments of 12½ percent. The tenant continues to pay rent on the portion still owned by the housing authority.

Like the purchaser of privately built housing, the public housing tenant-buyer can deduct mortgage interest payments from taxable income. The trouble has been that, if the low-income purchaser pays little or no income tax, the mortgage deduction is

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2 Decreased from three years in legislation passed in 1983.

3 Prior to the 1983 legislation, the maximum discount was 50 percent after 20 years.

practically worthless. Since April 1983, however, a low-income buyer in Britain has been able to utilize the Mortgage Interest Relief at Source Program. Under this, he can obtain a cash subsidy equal to the tax relief to which he is entitled (at the 30 percent lowest bracket), less the amount he can actually deduct from his tax bill--in effect a refundable mortgage deduction.

4) Value Recapture

A tenant-buyer cannot buy his unit one day with a 60 percent discount, sell it the next at the full market rate, and walk away with the difference. If the unit is sold within one year of the initial purchase, 100 percent of the discount must be repaid. This repayment requirement falls by 20 percent each year until, after five years, the unit can be resold without the repayment of any portion of the discount.

ANALYSIS OF THE BRITISH EXPERIENCE

The British program of public housing sales has been highly popular and had profound effects on many neighborhoods. As the program's proponents expected, signs of home improvement activity, close attention to maintenance, and resident involvement in neighborhood issues have become evident in communities where tenants are buying. The reason for this is simple, says Conservative Councilwoman Hazel Weiberg, "ownership gives them a greater stake in the community."[4]

Distribution of Housing and Sales

Approximately one-third of all housing in Britain is publicly owned rental accommodation. This is above the average for Western Europe, and far above the 1.5 percent in the U.S. In addition, the mean income of families in British public housing is not far below that of owner-occupying families, and it is a shade higher than families in private rental units. One reason for this is that local housing authorities cannot evict tenants whose incomes rise above the initial threshold for their unit. Moreover, the right of tenancy in a public housing unit in Britain can be passed on to an heir who has lived with the tenant. British public housing structures also differ from those found in American cities. While there are many examples of blighted high-rise properties, more typical is the well-built duplex or four-unit walk-up in a reasonably stable neighborhood.

The sales of British public housing reflect these characteristics. Data for 1982, for instance, indicate that the average

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[4] "New Law Transforms Britain Into a Nation of Homeowners," Wall Street Journal, September 14, 1983.

income of tenant purchasers was only 16 percent lower than that of all first-time house buyers in Britain, and 96 percent of public units sold were town houses, duplexes, or detached houses (only 4 percent were apartments). Nevertheless, sales were more common among lower-income public housing tenants than is usual for first time buyers. Forty-seven percent of public housing purchasers earned less than $10,000 a year (34 percent for all first-time buyers), and 14 percent earned less than $7,000 (9 percent generally).[5] Not surprisingly, in view of the discount based on length of tenancy, the average age of the tenant-buyer (43 years) was significantly above the average for first-time buyers (31).

Multi-Unit Buildings

The data indicate that the bulk of public housing sales in Britain have constituted purchases of fairly desirable types of housing to tenants who would not be classified as very poor. So American policymakers should not assume that the typical Right to Buy sale involves a welfare mother buying her high-rise apartment.

Indeed, it is the high-rise apartment that has been the most difficult for local authorities to sell to tenants. British officials are quick to point out, however, that a high proportion of Britain's multifamily urban public housing was built after the Second World War with poor material and designs. Inadequate durability and structural problems make these units very unattractive for purchase, even at low prices. Would-be buyers in such buildings are inclined to remain on the waiting list for a more desirable property (using the waiting time toward a larger discount).

A second key factor is the unfamiliarity of the British with mechanisms such as tenant management or cooperative ownership. Tenant management is almost unknown in Britain, and cooperative ownership is rare. Consequently, say British officials, tenants have a strong resistance to the only forms of purchase and organization that are practical for low-income people in multifamily buildings. Even when a tenant buys his home in a 4-unit walk-up, the local authority usually retains the responsibility for the common areas and general maintenance (with a service fee), rather than have the owners accept this responsibility.

Lessons of the British Model

Despite such differences between the U.K. and U.S. situations, the British program contains important lessons for a workable approach on this side of the Atlantic.

The first is that a discount based on length of tenancy is a powerful stimulus and a means of favoring the most stable tenants.

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5 Assuming one pound = $1.40.

Initial fears that the discounts would provoke anger among working-class buyers of private homes (who enjoy no such discount) proved groundless. The discount strategy has enabled many long established tenants to become even firmer anchors in the community.

A second lesson is that the resale value recapture mechanism is an important ingredient of the British program. It discourages rapid resale--which would undermine the otherwise stabilizing features of the program. On the other hand, the prospect of capital gain is important to a purchaser. In neighborhoods where market prices are not rising, or even falling, the sliding scale recapture provision in Britain allows for a potential capital gain within a reasonably short time.

The third lesson is that an American version of the British plan would have to overcome the problem of selling apartments to low-income tenants. Given the familiarity of Americans with cooperative ownership, this should present fewer problems than it has in Britain. Nevertheless, the high concentration of low-income people in American public housing would require more creative financing arrangements than are typical in Britain.

A PROGRAM FOR THE UNITED STATES

Since 1949, Congress has targeted the public housing program increasingly toward lower-income and welfare families, rather than those with modest incomes. Unlike Britain, therefore, the family income of a typical American public housing tenant is well below the national median--posing problems for any sales policy. Legislation does give a Public Housing Authority (PHA) in the United States the power to sell a "low income project to its lower income tenants." The sale price is usually based on the portion of the original development cost still outstanding--not the current market value. So discounted sales are permissible in the U.S.

This and other legislation have led to a number of home ownership programs for low-income tenants. The Turnkey III program, begun in 1968 and terminated in 1973, used the PHA framework to develop housing projects for sale, on a lease-purchase basis, to groups of public housing tenants with sufficient incomes to permit a sale without continued operating subsidies. The price was based on the total original development costs, and if the buyer were to resell the unit within five years of receiving full title, the PHA was entitled to recapture the capital gain according to a sliding scale. A requirement for success was the ability of the buyer to undertake basic maintenance and to accept the financial and other obligations of ownership.

Similar problems arose with the Section 235 Homeownership Program, another major federal initiative to encourage low-income homeownership through the sale of new or extensively rehabilitated units. The income problem was compounded in the case of Section

235 by the low (3 percent) down payment requirement--which could be in the form of "sweat equity" (that is, provided in the form of on-site work rather than cash). This meant that the loan-to-value ratio could easily come to exceed 100 percent in an unstable neighborhood--encouraging others to abandon their properties at the first need for substantial maintenance outlays.

The most extensive and perhaps most interesting low-income ownership program, however, has been the Indian Mutual Help Ownership Opportunity Program, which constitutes 61 percent of HUD assistance in Indian areas. Families or tribes must make a down payment contribution of at least $1,500 toward each unit, in the form of cash, land, or work. The resident can acquire title to the unit, generally after 25 years, through a lease-purchase plan that allows equity to be built up gradually. The program has been very popular and effective, covering over 30,000 units.

Mutual housing associations (MHAs), as a homeownership vehicle for public housing tenants, have attracted considerable attention in recent years. Proposals are now being formulated in Patterson, New Jersey, for example, which would use the model to transfer 242 public housing units into tenant ownership. The title of the building first would be transfered to a mutual housing association made up of residents. This MHA would be affiliated to a city-wide MHA with a board of directors drawn from city officials and local organizations. This city-wide MHA could enlist support and provide technical assistance for would-be buyers, thereby improving the chances of successful ownership by individuals, who would be able to purchase title from the MHA.

THE PRINCIPLES OF A NEW OWNERSHIP INITIATIVE

Drawing on British and American experience in encouraging ownership among low-income tenants, principles for a successful homeownership program for public housing tenants emerge. Among them:

1) Discounts and Equity

It is clear from the problems associated with Section 235, and in contrast, the success of the British approach, that buyers must feel they have sufficient stake in their homes to justify expenditures on maintenance. Discounting the price (giving the prospect of a substantial capital gain) would provide that stake indirectly but effectively: a token down payment does not.

Current law permits HUD to sell to a resident tenant at a discount with the federal government paying off part or all of the existing capital debt. Similarly, units can be modernized without the tenant-buyer being required to pay the cost of modernization.

2) A Subsidy to Buyers

Some critics of discounted sales to low-income buyers charge that this constitutes an unfair valuable subsidy to the buyer. These critics overlook the mortgage deduction available to middle- and upper-income buyers--which is of little value to low income buyers. If the purpose of Treasury assistance is to help home-buyers, then a price discount on public housing would be a rational and equitable device to help low-income buyers. Depending on the discount chosen and the tax savings (if any) usable by purchase, a case could also be made--again on equity grounds--for some interest relief for low-income buyers. It would be reasonable for the interest payable on PHA-provided mortgages to be reduced by an amount at least equal to the lowest marginal federal tax rate.

3) Netting for Other Subsidies

Subsidy calculations should also be adjusted for the subsidies to other groups already included in the cost of public housing. American Enterprise Institute scholar John Weicher notes that studies suggest that new public housing units cost about 25 percent more than comparable private housing. The major reasons for this are the high tax revenue costs associated with tax-exempt financing often used in such projects (a subsidy to higher-income investors) and high construction costs due to the application of the Davis-Bacon Act (a subsidy to construction workers).[6] There seems little justice in forcing low-income homebuyers to cover the capital cost of a subsidy to Americans earning well above their income. The cash basis for any calculation of purchase price, therefore, should net out such subsidies.

4) Developing Homeowner Attitudes

A major problem associated with low-income buyers, even if financing can be arranged, is that they often lack the maintenance and accounting skills needed for homeownership. On the other hand, some remarkable successes have been achieved with tenant management associations as vehicles to encourage sound maintenance techniques--especially when cash incentives were utilized. As head of Newark's public housing in the 1970s, for instance, Tom Massaro sought to cut costs by inviting tenants to take over many responsibilities. For every dollar this saved the city, the tenants were allowed a portion to finance community activities. The result: vandalism and utility costs plummeted and tenants acquired useful maintenance skills.

Another tenant management association in Kenilworth Courts, Washington, D.C., has achieved dramatic cost reductions by training

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6 John C. Weicher, Housing (Washington, D.C.: American Enterprise Institute, 1980), p. 59.

its own tenants in management and maintenance skills. A preliminary study by the American Enterprise Institute's Neighborhood Revitalization Project found that within one year of the 1982 turnover to tenant management, administrative costs were cut by 63 percent, and maintenance (the major outlay) by 26 percent. In addition, rental income was increased significantly, thanks to improved collection and reduced vacancy rates, such that the project began to run a healthy operating surplus.

Success as a tenant management asssociation could be a sensible prerequisite to apply to a group of public housing tenants wishing to purchase as a cooperative. An alternative requirement would be the creation of a private Mutual Housing Association, as that suggested in Patterson, New Jersey, to provide management assistance and training to achieve operating cost reductions. The tenants would be members of this association, which could foster cooperative or any other suitable form of tenant ownership. Another equity-building approach would be for the tenants to enter into a lease-purchase agreement. The operating subsidy would then be capped, and savings achieved by the tenants would be accumulated as equity shares until the full purchase could be accomplished, whereupon title would be transferred.

The savings achievable through tenant management is critical both to the success of any ownership plan and to the number of tenants that could hope to utilize it. Most studies of the potential for ownership among public housing tenants suggest that it is very small. But these calculations ignore the substantial reductions in cost that can be achieved--if tenants have an incentive--and thus grossly underestimate the possibilities of ownership.

A PUBLIC HOUSING HOMEOWNERSHIP PROGRAM

The Administration, utilizing existing law and with the agreement and cooperation of communities and PHAs, should experiment with a homeowner program for public housing tenants. The President should make it clear that the objective is not to raise income but to promote ownership in poor communities. Special buildings for the elderly or the handicapped should be excluded from the program, so that the number of such units available for rent would not be reduced.

In addition, Congress should enact a "Public Tenants Right to Buy Program." The measure should give groups of tenants the right to be included in the homeownership program, even if the local PHA opposes ownership. Such a group of tenants would apply directly to the Secretary of HUD. If eligible, according to the criteria below, HUD would set in motion the ownership process, and the PHA would be required to provide the resident association with a mortgage according to HUD rules. Legislation should also be enacted to expand the housing voucher program so that tenants

unable to buy a share of a co-op, or other ownership vehicle, such as lease-purchase, could continue as renters.

Eligibility

The program would center generally on purchases by successful tenant management associations. As the tenant management associations or mutual housing associations improved tenant skills and reduced operating costs, savings to the PHA would be placed into an escrow account toward the purchase price, or as the equity element of a lease-purchase agreement. The purchase process would begin when this transitional arrangement reduced running costs sufficiently for the tenants to have a reasonable chance of meeting the costs of ownership.

To be eligible for membership in the purchasing organizations, tenant-buyers should have been good tenants in the specific building for at least one year and good public housing tenants for at least three years. This would help assure stable buyers of good character. Tenants unable to meet this criterion would not be permitted to purchase.

Discount and Resale

An eligible association, comprised of eligible tenants, would be allowed to purchase the building at 30 percent of the assessed market value. No down payment would be required. If a co-op member were to sell his share within the one year, his portion of the entire 70 percent discount would be repayable to the PHA. This repayable portion would fall by 10 percent annual segments (of the initial market price) until, after seven years, the member would be free to keep all resale proceeds. The prospect of gain should be sufficient to establish the notion of equity, and so offset the lack of a down payment.

Financing

Eligible tenant management associations accepted into the program would have the right to a mortgage from the PHA under the legislation proposed. Since the PHA would be the owner of the building in the first place, this would involve no transfer of cash, only the replacement of rent payments to the PHA with mortgage payments. The interest rate on the mortgage would be adjusted to reflect the marginal tax benefits available to typical first-time homebuyers.

Tenant associations could purchase outright or purchase according to a shared-equity plan. With either method of purchase, the housing authority would continue to operate the units occupied by tenants refusing or ineligible to join the ownership associations. Existing tenants, in other words, would not be evicted. Eligible tenants could, however, buy into the purchase plan at any time. If some of the tenants continued to remain renters, supported by the government, that portion of the building would

be considered a set of units owned by the PHA--thus the PHA would not be a shareholder in the cooperative. However, maintenance services to these units could be provided by the tenant ownership association under contract. An alternative might be for the federal government to guarantee to the association owning the building that vouchers would be provided to meet the costs of units still occupied by tenants.

Under a shared-equity arrangement, the tenant association could, in effect, buy a portion of the unit (minimum 50 percent) and continue to pay rent to the PHA on the remainder. The association could add to its ownership in increments, as finances permitted. Payment could be made in-kind (such as maintenance work) to obtain additional ownership shares. An alternative approach would be a lease-purchase arrangement, where tenants could build up equity credits, but would not take title until they could finance the entire sale price of the building.

Resale

The part-owner could sell his unit in the normal way, subject to the provisions regarding discount repayment, but he would have to return the original cost of the rented portion of his unit to the PHA. Alternatively, he could sell his share to an eligible buyer willing to take on his shared equity responsibilities. The tenant would have the right to a mortgage from the PHA, with a limit based on income and a below-market interest rate, offsetting the reduced tax relief available to low-income tenants.

CONCLUSION

The program suggested is not a proposal to sell off public housing to developers or suburban homesteaders. It is a device to provide ownership opportunities for existing tenants of public housing projects. If successful, it could transform some of the most troublesome communities in the nation's urban areas. It draws on the known successes of tenant management associations and that powerful ingredient of commitment to neighborhood--ownership. Turning public housing tenants into homeowners in this way would utilize the strengths and ownership dreams of residents themselves to help overcome the debilitating problem of America's inner cities.

Stuart M. Butler
Director of Domestic Policy Studies

Senator SYMMS. Well, I appreciate your testimony very much and I hope you will stay at the table and Congressman Kemp can come up and be seated. While he's preparing, I might just say that I think some of the resistance from this will come from those people who have always derived their votes from promoting the Government sector, and by being able to hand out favors from Government.

Mr. BUTLER. That was certainly true in Britain.

Senator SYMMS. Did that prove to be true in the British experience?

Mr. BUTLER. Very, very clearly.

Senator SYMMS. So after they went from being a tenant in government housing to owning, they started voting for Mrs. Thatcher?

Mr. BUTLER. That was a widely noted phenomenon in the 1983 election.

Senator SYMMS. Congressman Kemp, we welcome you here this morning. Congressman Kemp is well known in the United States and I have told many people even several years ago that he was the Republican leader policymaker in the United States and I think that has proven to be true. Certainly he's in the forefront of many of the supply-side issues.

We can't help but note the fame he's gained as a political leader in Washington, and the positive influence he's had on Ronald Reagan and on the Republican National Committee platform. But those are all much less important than the fact that he is known now as the father of Jeff Kemp, the quarterback for the Los Angeles Rams. Many of us were thinking of you last Sunday, Jack, when we saw Jeff's fine performance.

Representative KEMP. I spent 13 years in pro football and 14 years in Congress, have given 67,000 speeches around the country, and my son has one game and eclipses my whole career.

Senator SYMMS. Please go right ahead.

STATEMENT OF HON. JACK F. KEMP, A U.S. REPRESENTATIVE IN CONGRESS FROM THE 31ST CONGRESSIONAL DISTRICT OF THE STATE OF NEW YORK

Representative KEMP. Mr. Chairman and members of the committee, thank you for allowing me to testify. I have been listening at least to part of Stuart Butler's testimony and he is really one of the leaders in this whole movement.

I think, Mr. Chairman, you pointed out something that is extremely important by holding these hearings and that is that there are those who see the poor as perpetually poor. They see poverty as a perpetual state of the human condition. They see the wealth of the Nation as static and unable to grow. I think, Mr. Chairman, by holding these hearings, you are opening up a whole new vista in the debate over the inner-city poor and the poverty-trap that many men and women find themselves in.

There are some innovative ideas. Several of those have come from Mr. Butler, Mr. Chairman, and others in this area who are in the center or to the center right in the political spectrum. And I think it's interesting—not to turn this into an ideological debate—but many of the new ideas coming forth on ways of fighting pover-

ty are manifesting themselves among those in the center right of the political spectrum. I don't say that to be smug, Mr. Chairman, simply to suggest that some of our friends on the left have lost sight of the fact that poverty is not a condition of perpetuity, that life is not a static zero sum game, that men and women in the inner-city and those in poverty are a resource and they have the same potential, the same future to produce wealth and opportunity for themselves and their children as anyone else if we remove the barriers that stand in their way of achieving and producing and engaging in entrepreneurship.

Historically, the cities have been a great wealth of resource, a great wealth of talent. Many of the ideas that sparked the industrial revolution came from the inner-cities and somehow we have grown accustomed all too often in recent days and years to think, Mr. Chairman, that those in the inner-city, men and women trapped in poverty, are there ad infinitum.

What I appreciate about your willingness to hold these hearings is to give some opening, some wedge driven into this static model of life and wealth. I it goes back to the classical view that wealth can be generated, wealth can be expanded, opportunity can be enhanced, that people in and of themselves are a great resource, that the minds of men and women freed up and unleashed and unfettered is the greatest resource on this Earth. Notwithstanding, of course, many other physical resources, the metaphysical talents of people, their spiritual talents and their mental talents are really the source of all wealth and all ideas.

So interestingly enough, there are those who love the poor so much they want to keep them perpetually poor. There's a heck of a lot of votes in making sure that the economy is in a perpetual state of contraction where people have to go to the Government for assistance. I think that those of us who are trying to find solutions in the private sector to some of these social and economic problems need to go on the offense, Mr. Chairman, and need to carry this intellectual debate to a higher level of consciousness.

For instance, Mr. Butler and others, including yourself and myself and many of our friends on the Democratic side of the aisle, have advanced the idea that we ought to, in inner cities, advocate green lining those formerly red-lined area. I call it free enterprise zones. Mr. Butler calls it urban enterprise zones. It doesn't matter what the name or title is, but we ought to dramatically change the incentives in order to change the behavior of people.

Now I don't want to sound like B.F. Skinner, Mr. Chairman, but we need to alter the rewards in the inner city for the level of activity which we want to see encouraged. And what do we want to see encouraged among poor or those who are in cycles of poverty? We want to see production. We want to see education. We want to see investment and savings. We want to see their lives broadened and their hopes expanded. And I don't think there's any more important reason for the political process, Mr. Chairman, than to bring hope to those who have impoverished dreams and aspirations.

So from that standpoint, you mentioned tax policy—I personally advocate abolishing the Federal income tax for any family of four through $14,375. Right now it is nearly impossible for the welfare mother or parent to take a job. He or she loses benefits and the

State and the Federal Government nails the person to the wall by taxing income so heavily that in some parts in this country a family of four must earn close to $18,000 or $19,000 of pretax income by working in order to match the equivalent of an $8,000 or $9,000 nontaxed transfer payment income on welfare. In other words, that's a 150-percent, marginal, income tax bracket into which the znner-city poor have been pushed.

It isn't their fault, Mr. Chairman. We have destroyed opportunities. We have create a blight not only on their lives but on the Nation's opportunity to created new jobs in the inner city. I think we really ought to seriously consider something radical. I hesitate to use that word because it has a connotation that is many times pejorative—but in the context I'm using it today I suggest radical in the sense of getting back to roots, getting back to foundations, in the Latin sense getting back to the premise that we should create opportunity to get access to income and property in the inner city.

One other thing that could be done besides abolishing the Federal income tax for families of four up to $14,375 in urban enterprise zones is this whole concept of urban homesteading. You give a man or woman a job, give them the chance to get access to property and income, give them access to a home, and with proper job training through the Job Training Partnership Act and other innovative new ideas in educational and vocational training for jobs, I really believe that we could literally within a very short period of time in this country reverse the cycle of poverty and welfare that has entrapped not just one generation, Mr. Chairman, but numbers of generations. And it is absolutely a blight on not only the American dream for those people, but also on our capacity to have a country that operates at its highest optimum level of output.

This whole idea now of urban homesteading is capturing the imagination of many people in this country.

Mr. Butler alluded to the United Kingdom. I met recently with the Deputy Finance Minister of Israel, the Finance Minister of Australia, and the Finance Minister of West Germany. It is exciting to see some of these ideas leaping across oceans and leaping across continents because ultimately, Mr. Chairman, as you have so well pointed out in the past, ideas have consequences, they rule the world, and the most positive application of these ideas are now coming from governments and people who heretofore have been associated in the past with a negative response to what some of our friends on the left have come up with.

I really think this idea of urban homesteading, while not perfect and certainly not a panacea——

Senator SYMMS. Have you introduced the bill in the House yet?

Representative KEMP. We just did and I want to explain it very quickly, Mr. Chairman. We introduced it yesterday with only a few cosponsors. I wasn't looking for a lot of cosponsors, Mr. Chairman. I was actually trying to get the bill in so we could begin the debate and like the Kemp-Kasten bill or the Bradley-Gephardt bill or the enterprise zone bill or urban homesteading bill, all we are trying to do is stimulate thinking about what we can do in this country to break out of this cycle of welfare.

Senator SYMMS. In this particular struggle you don't need a lot of cosponsors on this bill.

Representative KEMP. That's true.

Senator SYMMS. Because a radical concept really doesn't need a lot of sponsors. It is a good idea and it should start promoting the discussion. We will get it introduced on this side before the session ends.

Representative KEMP. Abraham Lincoln had homesteading—not urban, but the Lincoln Homestead Act was one of the most progressive and positive applications of the idea of homeownership and letting a man or woman or a family work land, get an equity position in the land, and we literally turned this country into a state of expansion. But you must expand someone's ideas and their vision before you can actually see the manifestation of that process at work in the wealth of the Nation.

Senator SYMMS. I'd just like to say further that if Lincoln's Homestead Act could have been continued, we have in the Pacific Northwest 60 percent of all the soft wood timber that stands in the United States. This is mature timber, that at the present level of management is going to rot on the stone or be blown over or burned out. If that land could be made available for people of less economic advantage so they could go out and use it and farm it and harvest that timber, there's an enormous amount of capital available in the Pacific Northwest. 75 percent of that 60 percent what I'm speaking of is owned by the U.S. Government, and it's basically off limits. We just had a bill in the Senate yesterday dealing with that problem—the result of trying to have private enterprise sawmills as captives of the Government's ownership system, where they created the shortage in the first place because they won't allow access to the timber.

I'd love to take some of your enthusiasts out and show them the potential. When you see some of the problems the American Indians have were they've been entrapped on their reservations, how much better off they would be if they could just be given a few thousand acres of land out there and turn them loose, they could produce and haul the trees down to the road and the big lumber company could come by and buy from them. It would be a marvelous opportunity for millions of people and it's being literally wasted today under the Government's ownership and management techniques.

Representative KEMP. Well, I appreciate your comments.

Senator SYMMS. The fact is, the Government put all the sawmills in bankruptcy out there because of their Timber Sale Program.

Representative KEMP. The Heritage Foundation has done some incredible work, Mr. Chairman, in this area and I think seeds planted by a relatively few people do have an impact, not just in urban areas but, as you pointed out, in the whole vast area of this country and, of course, the world.

American Enterprise Institute's Cicero Wilson, Bob Woodson of the Center for Neighborhood Enterprise, Dr. June Koch, Assistant for Policy Development and Research at HUD—there are many people who have really been advancing these ideas and its' burgeoning very quickly, Mr. Chairman.

Let me explain very quickly what the details are, not to be very specific, but at least to recognizing there's a beginning step being taken.

Basically, tenants in public housing projects could form tenant associations. This has been done in Washington, DC. It's been done in Cochran Gardens in St. Louis. It's been done in Louisville, KY, and Louisiana. All of these projects have helped turn some of the worst housing projects in the country into showcases. They have been success stories, Mr. Chairman, where tenants and others have demonstrated that they can handle full responsibilities and the privileges of homeownership. The cost of utilities has come down because people begin to recognize that they're using something that has a price. We are reestablishing the price rule public housing.

We want to take this national effort and build on the efforts and aspirations of existing and future tenant-managed projects. We don't want to make it an entitlement program. We're not going to give away housing without requiring a stake by the tenant themselves. That would defeat the purpose.

Our bill would put homeownership and tenant management in striking distance for deserving men and women who demonstrate they can handle the responsibilities and costs of homeownership.

The premise and detail of our plan, Mr. Chairman, which as I say is only a beginning step, will proceed along the following line. First, the tenants in public housing would form a tenant association. Second, they be trained and educated in efficient management of those projects. Third, they could buy the project at a dramatic discount from the market value after they have demonstrated that they can bear the costs and responsibilities of ownership and project management.

As I said, Mr. Chairman, this is being done in many areas of the country. Our premise is that tenants themselves would show their interest and support for homeownership by forming that association with an intention to buy. The association, not HUD or the local public housing authority, but the homeowners association would initiate and plot the course for the eventual conversion of the project to private ownership.

Our approach does not bypass the housing bureaucracy but neither does it allow public housing authorities to arbitrarily block homeownership, which is one of the impediments that stands in the way of that family beginning to have a stake in private ownership.

Our responsibility, however, doesn't end with putting a for sale sign on Government housing projects. We need to go further. Our bill envisions a partnership involving labor, business, local housing authorities, civic organizations, foundations, and especially poor people themselves, to make the dream of homeownership a reality.

It's obvious that training and education and counseling are important responsibilities, but also job skills, financial management, and home care maintenance.

Is this asking too much?

Mr. Chairman, the experience of a tenant-managed project give a resounding "no."

Public housing projects can become a focal point for many self-help projects, like the administration's Job Training Partnership Act, the Enterprise Zone legislation, and so forth. Local civic groups—Leon Sullivan in Philadelphia, Opportunity Industrial

Centers, have probably one of the most outstanding records in job training and in training rehabilitation and these are the type of local organizations at the community level, including the Urban League and others, who have a tremendous impact upon the ability to convert some of these housing projects to private property or homeownership.

We have received a lot of encouragement, Mr. Chairman, from real estate associations, life insurance firms, foundations and businesses ready to contribute to training, management, and technical expertise and even seed capital. Local governments, although this would be controversial, might want to provide tax abatement. I do not envision that that will be necessarily part of the bill, but it would be encouraged if the local community wished to do so. I don't think we should impose it upon them.

Our second premise, Mr. Chairman, is that public housing must be sold at a large discount since obviously most tenants are quite poor, and the first argument will be, well, gee, if they only earn $5,000, or $6,000, or $7,000 a year, how are they ever going to afford to buy their own stake in that project? Well, obviously a large discount is required to help facilitate what is beyond the means of the most poor. A homeowners association could purchase the dwelling at no more than 25 percent of market value, no downpayment. The public housing authority would take back the mortgage at a reasonable rate. To bring homeownership into the reach of even more poor people tenants themselves could build equity in their homes by contributing their talent and labor as part of the investment. They would work that property for 2, 3, or 4 years to show their willingness to invest what has been called sweat equity into that future investment.

Third, to protect all public housing tenants, our bill provides a number of important safeguards for the tenant and the homeowner. Tenants who don't choose to buy either would continue to rent as now from the public housing authority or would receive a housing voucher from the Government equal to or better than their current housing assistance. No tenants could ever lose their home as a consequence of our bill.

To prevent premature or hasty transfer of ownership, title would be transferred to tenants only after HUD certifies that they and the homeowners association can afford the cost and responsibilities of that private ownership. Under our bill, the Department of Housing and Urban Development must bring the housing up to decent standards before being sold. But frankly, some of the areas are so deteriorated right now that just telling people that they can get a stake in ownership immediately reflects itself and manifests itself in an upgrading of the property: Cleaner facilities, better kept yards, lower cost for utilities, savings to the Government and the taxpayers. We could actually save money.

Aside from construction costs, taxpayers now pay over $3 billion yearly in operating and modernizing subsidies for public housing, about $2,000 per unit per year. Many public housing projects can achieve economic self-sufficiency, can operate on a break-even basis, without Government subsidy.

The payoff, Mr. Chairman, is not only reduced Government subsidies but significantly higher property values. It expands the tax base, Mr. Chairman.

This is just a sketchy outline of the plan. As I say, this isn't the final draft. This is the first draft. This is not the final word, this is the first word. But that's how the base begins, Mr. Chairman, and I just want to praise you and thank you. I realize not a whole lot of people are here today, but it doesn't take a lot of people. This young man on my right and other friends of this movement have really contributed I think to a far more positive and progressive debate over breaking the cycle of poverty and welfare in this country, and I just want to say that I think it is opening up a whole new frontier in terms of thinking and that's good news for our country.

[The prepared statement of Representative Kemp, along with attachments, follows:]

Prepared Statement of Hon. Jack F. Kemp

The Urban Homestead Act of 1984: A Plan for Turning Tenants into Homeowners

I welcome the opportunity to testify today on the Urban Homestead Act, a new bill which I have just introduced along with some of my colleagues, which extends homeownership opportunities to thousands of public housing tenants who yearn to own their own home. I would like to recognize the important contributions and efforts in this regard of Heritage Foundation's Stuart Butler, American Enterprise Institute's Cicero Wilson, Bob Woodson of the Center for Neighborhood Enterprise, Dr. June Q. Koch, Assistant Secretary for Policy Development an Research at HUD, and the many others who have provided important assistance and advice on my bill.

In all our efforts, we have striven to achieve one major goal: to make the dream of homeownership a reality for thousands of public housing tenants--often poor, black, and on welfare--who don't have a strong voice in Washington, who feel left out of our economic system, and who have often become alienated from our political system.

We want to let these people know that their aspirations, their hopes, and their dreams are our own. That the American dream of homeownership is not just for the well-to-do, or even the middle class, but also for poor people who live in the most blighted areas of our inner cities. They too yearn for homeownership--a home they can afford, a home in which to raise a family in security and independence, a home in which to take pride while building and improving for the future and for their children.

Yet today most of the urban poor find it nearly impossible to own their own home. Not just because their income is low, interest rates high, and their credit worthiness doubtful, but also because tenants in government housing projects are not permitted to purchase their dwellings. We don't want to eliminate public housing or cripple its effectiveness. While there certainly are some bad housing projects, our goal is to enhance and improve this tremendous national asset by allowing public housing tenants the opportunity to buy their own home.

All of this is not to say that the public housing is trouble free. Far from it. Public housing discourages work and saving, raises numerous barriers to the upward mobilility of tenants, and sometimes has degenerated into dilapidated and depressing slums.

If a public housing tenant on welfare takes a job, for example, he faces effective marginal tax rates over 100%, due not just to federal, state, and local taxes on his earnings, but also the loss of government support payments as well. As the tenant's income increases, his rent would be raised accordingly. And he could be expelled from the project if his income rises too much. If a tenant marries, the additional income of a spouse may make them ineligible for public housing.

Tenants have little incentive to conserve utilities or properly maintain projects, and public housing authorities have just as little incentive to upgrade projects or fill vacant units, since they get paid whether the unit is vacant or filled. What a tragedy that over 60,000 public housing units lay vacant, while thousands of the poor are on waiting lists for an apartment.

I believe that homeownership can lift the aspirations, hopes, and self-respect of those in our inner city slums. When people become homeowners something dramatic occurs in their attitudes, character, and outlook. Families acquire new dignity, they begin to take pride in what they own, and they become more steadfast and concerned citizens in the community.

The mere act of homeownership transforms tenants, giving them a new sense of belonging and self-reliance. Homeownership encourages stable and intact families, creates a longer outlook on life and the future, and gives the poor new reasons to work and save. Homeownership can help give new life to the inner city poor by promoting human dignity, personal achievement, and social stability.

And in doing so, America itself gains in strength. Since the beginning of our country, tenantry has been viewed as unfavorable to freedom. The policy of free republics was always to multiply homeownership to increase the love of country, the spirit of independence, and self-reliance. Abraham Lincoln over a century ago endorsed a Homestead Act which opened up the Western frontier to the new immigrants and freed blacks seeking to own their own home. We name our bill in honor of Lincoln's Homestead Act since we share his objective of homeownership for all regardless of income, creed, or race.

Can it be done? Can poor people become the owners of their own homes? Many say no, that the economics of the poor preclude homeownership for all but the middle class.

I believe that many tenants would choose homeownership, if they were given a choice. Our inner city poor are our country's most important untapped resource. We can turn many of the poor into homeowners, if only we have the determination and imagination to make this goal a reality.

We already have tested and demonstrated examples of successful tenant-management of public housing like Ms. Kimi Gray of Kenilworth/Parkside Gardens who modernized a delapidated project, improved maintenance, and reduced costs to a point where the project is now self-sustaining. But what she really did was to lift the spirits and sights of her tenants. And the results were dramatic reductions in many social problems like crime, drug abuse, and vandalism. She and her tenants deserve to be homeowners.

This story is repeated in the charismatic leadership of other tenant managers, like Ms. Bertha Gilkey of Cochran Gardens in St. Louis, or Ms. Bonnie Downs of Iroquois Homes in Louisville, Kentucky, or Ms. Viney Reynolds of B.W. Cooper Homes in Louisiana--all of whom have helped turn some of the worst housing projects into showcase success stories. These tenants and others have demonstrated that they can handle the full responsibilities and privileges of homeownership.

I am proposing a determined national effort to build on the efforts and aspirations of the Kimi Grays and Viney Reynoldes to make private ownership the next reasonable and viable step for tenant-managed projects. We don't make homeownership an entitlement program. Giving away housing without requiring any stake by the tenant himself would defeat our purpose of promoting independence and pride among tenants. It would also be an affront to low and middle income Americans who must work hard to afford their own homes.

Our bill puts homeownership in striking distance for deserving tenants who have demonstrated that they can handle the responsibilities and costs of homeownership.

The premises and details of our plan, which is only a beginning step, would proceed along the following line: First, tenants would form a tenant association; second, they would be trained and educated to efficiently manage their projects; third, they could buy the project at a discount from market value after demonstrating that they could bear the costs and responsibilities of ownership and project management.

Our first premise is that tenants themselves would show their interest and support for homeownership by forming a homeowners association with intention to buy. The homeowners association, not HUD or the local public housing authority, would initiate and plot the course for eventual conversion of the projects to homeownership. Our approach does not bypass the housing bureaucracy but neither does it allow public housing authorities to arbitrarily block homeownership.

Our responsibility, however, doesn't end with putting a "for sale" sign on government housing projects. We must go much go farther. My bill envisions a partnership involving labor, business, local housing authorities, civic organizations, foundations, and especially poor people themselves, to make the dream of homeownership a reality. Aspiring homeowners must be trained, educated, and counseled not just on managing the responsibilities of home ownership, but also on job skills, financial management, and home care maintenance. Is this asking too much? The experience of tenant-managed projects gives a resounding no.

Public housing projects can also become the focal point for many self-help efforts like the Administration's Job Training Partnership Act and its Enterprise Zone legisation which promote job skills, enterprise, and new business to greeenline distressed inner cities which too often have been blacklined against private enterprise and growth. Local civic groups like Rev. Leon Sullivan's Opportunities Industrialization Center, which has done outstanding work in training rehabilitation experts from the ranks of the unskilled, should also be tapped.

We have already received encouraging support from real estate associations, life insurance firms, foundations, and businesses ready to contribute training, management and technical expertise, and even seed capital. Local governments could provide tax abatement. In short, our homeownership initiative is more than just signing papers, it is an entire urban revitilization strategy around the inner city family's most cherished possession:

its home.

Our second premise is that public housing must be sold at large discounts, since obviously most tenants are quite poor. To help facilitate what is beyond the means of most poor, a homeowners association could purchase their dwelling at no more than 25 percent of market value and no down payment. The public housing authority would "take back" a mortgage at reasonable rates (no more than 70 percent of market interest rates). To bring homeownership into the reach of even more poor people, tenants themselves could build equity in their homes by contributing their own talents and labor as part of their investment.

Third, to protect all public housing tenants, our bill provides a number of important safeguards both for tenants and the homeowners. Tenants who don't choose to buy either would continue to rent as now from the public housing authority or would receive a housing voucher from the government equal to or better than their current housing assistance. No tenants could ever lose their home as a consequence of our bill.

To prevent premature or hasty transfer of ownership, title would be transferred to tenants only after HUD certifies that they and the homeowners association can afford the cost and responsibilities of homeownership. Under our bill, the Department of Housing and Urban Development must bring the housing up to decent standards before being sold and would provide continuing assistance as needed even after conversion to private ownership.

Taxpayers also gain from the Urban Homestead Act. Aside from construction costs, taxpayers now pay over $3 billion yearly in operating and modernizing subsidies for public housing, about $2,100 per unit a year. Many public housing projects can achieve economic self-sufficiency and can operate on a break even basis without government subsidies. The payoff is not only reduced government subsidies, but significantly higher property values for businesses and taxpayers in neighborhoods near public housing projects.

Now, this is a sketchy outline of our plan. Clearly, this involves a great many issues and raises a number of problems. But nothing in this plan has not been done before on a smaller scale and has not been already tested and tried with success. What is really new is our strong determination to make homeownership available to low-income families in America's cities. Considering the greater security and peace of mind, the tremendous boost in morale and dignity, and the opportunity to rebuild our inner cities, shouldn't we be looking at ways to turn tenants into homeowners? There is no more rewarding investment than helping some of America's urban poor realize an important and lasting stake in the American dream.

The Urban Homestead Act of 1984

Mr. Jack Kemp (for himself, Mr. Bliley, Mr. Siljander, Mr. De Wine, Mr. Whitehurst)

Should public housing tenants be given the opportunity to buy their dwellings at a substantial discount from the federal government?

We can make public housing a tremendous asset for our nation's poor by allowing public housing tenants to buy their own home. Homeownership, which can be a central element in revitilizing America's inner cities, is not just for the well-to-do, or even for the middle class, but also for poor people who live in some of the most blighted areas of our inner cities.

The Urban Homestead Act of 1984 offers public housing at deep discount and preferential interest rates to the tenants residing in those units. Only private property will be maintained, respected, and improved. Property which no one owns will always be abused. Homeownership would create pride, improve ghetto neighborhoods, enhance independence, and encourage stable and intact families.

The Housing Act of 1937 gives the Department of Housing and Urban Development the authority to sell public housing to tenants on any terms it wishes. This authority, however, has rarely been exercised, in part because of the public housing bureaucracy's natural resistance to ideas that would endanger its power, authority, and jobs.

We applaud the recent decision of the Department of Housing and Urban Development to set up demonstration projects to experiment with various homeownership options. Our bill, however, goes one step farther, by offering homeownership opportunities to all public housing tenants, and not those in just a few selected cities. And we set up specific guidelines and terms for the purchase, rather than leaving the initiative open to local public housing authorities that may be resistant to the tenant's wishes. Our approach bypasses the housing bureaucracy and gives tenants themselves the opportunity to initiate a purchase agreement with HUD.

Background

With the Housing Act of 1937, the federal government began a major effort to subsidize housing for low income workers. The program began with the government paying all capital costs of building public housing while tenants were expected to pay all operating costs. Given these financial arrangements, most public housing projects did not serve the very poor but rather low income working families and veterans.

The National Housing Act of 1949, sponsored by Senator Taft, set a national goal of "a decent home and a suitable living environment for every American family." The Act began the first large scale expansion of low-income public housing by building some 800,000 public housing units to be managed by local public housing authorities. The Act focused on

the poor by requiring a "gap" of 20 percent between the incomes of tenants and the necessary income to rent decent quality housing in the private market.

Throughout the sixties and seventies, millions of public housing units were built, often after clearing slums and bulldozing existing housing. No longer for predominantly low income workers with a steady stream of income, public housing programs emerged as a cornerstone of President Johnson's War on Poverty. The Slum Clearance Act of 1949, which soon became Urban Renewal, displaced millions of the poor while exerting pressure on local housing authorities to expand housing programs.

As the population of public housing projects became poorer, the cost of supporting and operating government housing projects soared. Small operating subsidies began in 1961, but jumped greatly in the seventies after the Brooke Amendments limited tenant rents to 25 percent of income. In 1985, the federal government will contribute about $1.1 billion in operating subsidies to local public housing authorities. Combined with other housing support programs, the government's housing debt reached a peak of $245 billion in 1982.

Alarmed by this runaway growth in housing expenditures, the Reagan Administration has terminated most new construction of public housing, raised the tenant's rent contribution from 25 percent to 30 percent of income, and focused on upgrading existing projects and improving their management. The third largest welfare program, public housing expenditures were cut from $27 billion to $9.9 billion in the last three years. From a peak of 393,000 new units in 1977, annual new housing starts fell to 69,000 last year.

Under the Reagan Administration, the number of households receiving some government housing assistance has actually risen to 3.8 million in 1984 from 3.2 million three years ago. The Administration has spent from FY 1981 through FY 1984, $7.6 billion for modernization of public housing, and plans to appropriate an additional $8 billion from FY 1985 through 1989.

QUESTIONS AND ANSWERS

Question: Can tenants afford to own their own homes?

Public housing tenants are very poor. A recent HUD survey shows that 81 percent of public housing families have incomes of less than $6,000 a year. Half of the non-elderly households in public housing receive welfare benefits. Without some sort of preferential treatment only a small number of tenants could afford homeownership.

Under the Kemp pronosal, tenants would receive a 75 percent discount on the market value of their unit. Housing authorities would also take back a mortgage at a low-interest rate and apply any savings made by the tenants in their operating subsidy to their purchase price. Finally, the Kemp proposal permits tenants themselves to contribute their own talents and work effort as part of their investment in their home.

According to one housing expert, the market value of a typical three bedroom public housing unit would be $20,000, a two bedroom unit around $18,000, a one bedroom around $17,000, and an efficiency around $15,000. Given these estimates, a public housing family could purchase a three bedroom home for a total sales price of $5,000. With the preferential mortgage rates of Congressman Kemp's bill, the family's total monthly pre-tax mortgage payment would be no higher than $50 a month, far less than many now pay in rent, and they would be building equity in a home. The tenants of the New York City public housing authority, for example, have average incomes of $9,821 and the average rent is $171, which puts many tenants within striking distance of affording homeownership.

Question: What about the studies which show that only a small number of the poor can afford even the operating costs of homeownership?

First, even if only a small number of the public housing population immediately takes advantage of the homeownership option, we believe that they should be given the opportunity. Homeownership should not be made another entitlement program. Giving away housing without requiring any stake by the tenant himself, would defeat our purpose of promoting independence and pride among tenants and be an affront to other low and middle income Americans who must work hard to afford their own homes.

Our bill gives deserving tenants new reasons to aspire, work, and save for a home, just as middle income and working Americans must scrimp and save for their home.

The discounts and other assistance provided under the bill should place homeownership within the reach of aspiring tenants, perhaps in the $8,000 and over income range, which is within reach of a tenant working at slightly above the minimum wage.

One major flaw in the studies which show homeownership out of the reach of most tenants is that operating and management costs of most housing projects are unnecessarily high not just because they are poorly managed, but because tenants have little incentive to conserve utilities and maintain property. When tenants own and manage their own housing projects, operating costs have been brought dramatically. Calculating these savings, homeownership would be put into the reach of many who now appear unable to afford it.

Question: Aren't most public housing projects high rise ghettos that no one would want to buy?

Some housing projects are dismal places indeed--which underscores the importance of promoting home ownership to improve living conditions and upgrade neighborhoods. Contrary to public opinion, however, most public housing projects are quite livable and in good to excellent condition. According to a HUD survey in 1982, 43 percent of the housing stock was in good to excellent condition, 29 percent was in fair condition, and less than 28 percent was in poor condition. As a protection to all tenants, however, the Kemp proposal requires that public housing be brought up to decent living conditions before being sold.

Also contrary to conventional wisdom, not all public housing projects are high rise jungles that depersonalize and alienate the poor. A HUD survey found that 27 percent of the projects were high rise buildings, 32 percent garden apartments, 16 percent low-rise walk up apartments, and 25 percent of the projects, containing 10 percent of the units, were in single family detached or townhouse units.

Question: Won't this reduce the housing stock available to the poor?

No. Under the Kemp bill, public housing units will only be sold to the current residents. If tenants resell their house within five years of the conversion, they will lose a portion of the discount. Moreover, over 60,000 public housing units are now vacant, which if sold to low-income tenants could expand the housing stock. Privately-owned homes will be better preserved and maintained as a national resource for the poor than public housing which typically has a short lifespan. Housing vouchers, which the Administration is now experimenting with, will also be available for some of the poor who are not able to participate in the homeownership opportunity initiative.

Question: Isn't this an untried scheme?

To the contrary. Great Britain's conservative government sold over 800,000 of its public housing stock under a program resembling, but far less generous than, Congressman Kemp's proposal. While there are significant differences in the two countries public housing--for one Britain's public housing tenants have a much higher income than American tenants--the British example demonstrates the enthusiasm and support of lower income tenants for homeownership

HUD also has experienced mixed, but generally successful, results with limited homeownership programs in its Section 235 interest reduction program, the Turnkey II public housing ownership program, and its Indian Mutual Help homeownership program. Moreover small projects have been sold successfully to low income tenants in New York City; Puerto Rico; Selma, Alabama; Baltimore, Maryland; Poughkeepsie, New York; and Washington, D.C.

Question: What happens if tenant-homebuyers cannot make mortgage payments due to sickness, job loss etc?

Tenants and tenant associations must be certified that they can afford the cost of ownership before the project is converted. While unexpected difficulties could arise after the project is transferred to private hands, since the local public housing authority will be holding the mortgage on most projects, it can help delay mortgage payments until the financial difficulties are overcome. For this same reason, projects that become insolvent could revert back to the public housing authority, if necessary, to ensure that tenants will not lose their home.

Question: Suppose some residents do not want to buy?

Under the Kemp bill, tenants who don't want to buy are entirely protected. They may choose to remain in their unit and be given

a rent voucher or choose to be relocated to another project.

Question: What does the taxpayer gain from promoting homeownership among tenants?

Apart from the costs of constructing public housing, taxpayers now pay over $3 billion yearly in operating and modernization subsidies for public housing, about $2,100 per unit a year. While spreading homeownership among tenants would not acheive immediate and dramatic cuts in these costs, both operating subsidies and modernization expenses could be cut significantly as public housing projects were transferred to the private sector. As private homeowners, tenants would have greater incentive to conserve on utilities, better maintain housing projects, and improve their neighborhood, thereby reducing the need for government aid.

By instilling greater pride and better incentives, many tenant managed projects have also reduced many costly social problems, like teenage pregnancy, juvenile deliquency, and drug abuse. As a result, those taxpayers living in neighborhoods near current public housing projects would benefit from higher property values, safer neighborhoods, and reduced government social welfare expenditures.

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98TH CONGRESS
2D SESSION

H. R. _____

IN THE HOUSE OF REPRESENTATIVES

Mr. KEMP introduced the following bill; which was referred to the Committee on _____

A BILL

To amend the United States Housing Act of 1937 to provide additional homeownership and resident management opportunities for families residing in public housing projects.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

paragraph (5) for dwelling units in such project by an aggregate amount equal to such amount paid by the Secretary.

''(3)(A) A homeownership association may purchase all or part of a public housing project following a determination by the Secretary that--

''(i) such association is prepared to undertake the ownership, management, and maintenance of such project with continued assistance from the Secretary; and

''(ii) the operating costs of such project have been reduced sufficiently to provide the families purchasing dwelling units in such project with a reasonable prospect of affording the costs of homeownership.

''(B) Any family meeting the requirements of paragraph (1)(A) may purchase its dwelling unit directly from the public housing agency, if the Secretary determines that such purchase will not interfere with the rights of other families residing in the public housing project or harm the efficient operation of such project.

''(4) Notwithstanding the purchase of all or part of a public housing project under this section, the Secretary shall continue to pay annual contributions with respect to such project. Such contributions may not

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That this Act may be referred to as the ''Homestead Act of 1984''.

SEC. 2. The United States Housing Act of 1937 (42 U.S.C. 143/ et seq.) is amended by adding at the end thereof the following new section:

''PUBLIC HOUSING HOMEOWNERSHIP AND MANAGEMENT OPPORTUNITIES

''SEC. 20. (a) HOMEOWNERSHIP OPPORTUNITIES.--The families residing in each public housing project shall be provided with the opportunity to purchase the dwelling units in such project as follows:

''(1) A homeownership association shall be formed in the public housing project that--

''(A) has as its members each family residing in a dwelling unit in such project that--

''(i) is interested in purchasing such dwelling unit;

''(i) has resided in public housing projects for not less than 24 consecutive months;

''(iii) has resided in such dwelling unit for not less than 12 consecutive months; and

''(iv) is determined by the Secretary to be capable of assuming the responsibilities of homeownership;

''(B) follows democratic procedures in making decisions; and

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''(C) complies with such additional requirements as the Secretary may establish in regulations issued under subsection (e).

''(2)(A) The Secretary shall provide comprehensive improvement assistance under section 14 to public housing projects in which homeownership activities under this section are conducted in order to ensure that the physical condition, management, and operation of such projects are sufficient to permit and encourage homeownership by the families residing in such projects.

''(B) The Secretary, and the public housing agency owning and operating each public housing project, shall provide such training, technical assistance, and educational assistance as may be necessary to prepare the families residing in such project, and any homeownership association established under paragraph (1), for homeownership.

''(C) An amount equal to any reduction in the operating expenses of a public housing project realized as a result of the assistance provided under subparagraph (B) shall be paid by the Secretary to the public housing agency involved on behalf of the families residing in such project, and any homeownership association established under paragraph (1). Such public housing agency shall reduce the purchase price established in

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exceed the maximum contributions authorized in section 5(a).

''(5) The price for any purchase under paragraph (3) shall not be more than 25 percent of the fair market value of the property involved, as determined by the Secretary.

''(6)(A) Purchases under this section may be made under any of the following arrangements:

''(i) lease-purchase;

''(ii) shared appreciation;

''(iii) cooperative ownership;

''(iv) condominium ownership;

''(v) purchase with amounts borrowed on the security of the property involved; and

''(vi) any other arrangement determined by the Secretary to be appropriate.

''(B) For purposes of assisting any purchase by a family or homeownership association under this section, the public housing agency involved shall make a loan on the security of the property involved to such family or association at a rate of interest determined by the Secretary to be appropriate. Such rate of interest may not exceed 70 percent of the market interest rate on the date on which such loan is made.

''(7) If any purchaser of property under this section

sells such property before the expiration of the 5-year period following the date of such purchase, such purchaser shall pay the following percentage of the sale price to the public housing agency involved:

''(A) 75 percent, if such sale occurs during the first 1-year period following such date;

''(B) 60 percent, if such sale occurs during the second 1-year period following such date;

''(C) 45 percent, if such sale occurs during the third 1-year period following such date;

''(D) 30 percent, if such sale occurs during the fourth 1-year period following such date; and

''(E) 15 percent, if such sale occurs during the fifth 1-year period following such date.

''(b) RESIDENT MANAGEMENT OPPORTUNITIES.--The families residing in each public housing project shall be provided with the opportunity to undertake the management, maintenance, educational, and cultural functions of such project as follows:

''(1) A resident management association shall be formed in the public housing project that--

''(A) has as its members each family residing in such project;

''(B) follows democratic procedures in making decisions; and

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''(C) complies with such additional requirements as the Secretary may establish in regulations issued under subsection (e).

''(2) The Secretary, and the public housing agency owning and operating the public housing project, shall provide such training, technical assistance, and educational assistance as may be necessary to prepare the resident management association established under paragraph (1) to undertake the management, maintenance, educational, and cultural functions of such project.

''(3) A resident management association may undertake all or part of the management, maintenance, educational, and cultural functions of a public housing project following a determination by the Secretary that such association is capable of undertaking such functions.

''(c) PROTECTION OF NONPURCHASING FAMILIES.--(1) No family residing in a dwelling unit in a public housing project may be evicted by reason of the sale of such project to a homeownership association under this section.

''(2) If any family resides in a dwelling unit in a public housing project in which other dwelling units are purchased under this section, and such family decides not to purchase such dwelling unit, the Secretary may offer--

''(A) to assist such family in relocating to a dwelling unit in another public housing project; or

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''(B) to provide to such family a housing voucher determined by the Secretary to be appropriate to permit such family to obtain comparable alternative housing.

''(d) FINANCIAL ASSISTANCE.--(1) The Secretary shall provide to public housing agencies such financial assistance as the Secretary determines is necessary to permit such agencies to carry out the provisions of this section.

''(2) The Secretary may provide financial assistance to any homeownership association or family that has purchased property under this section for purposes of reducing the operating and maintenance expenses of such association or family with respect to such property. Such financial assistance may be made in such form (including housing vouchers) and in such amounts as the Secretary determines to be appropriate.

''(e) REGULATIONS.--The Secretary shall issue such regulations as may be necessary to carry out the provisions of this section. Such regulations may establish any additional terms and conditions for homeownership or resident management under this section that are determined by the Secretary to be appropriate.

''(f) ADDITIONAL HOMEOWNERSHIP AND MANAGEMENT OPPORTUNITIES.--No provision of this section may be construed to preclude the Secretary or any public housing agency from providing additional homeownership or resident management opportunities under section 5(h), section 6(c)(4)(D), or any other provision of this Act.''.

Senator SYMMS. Well, thank you very much. Your entire prepared statement and everything you said here this morning will be part of our record as well as yours, Mr. Butler, and I thank you both for being here. I can see one thing that we should think about in the future—the special interest lobbies that promote public housing here in town; if we start this program and people really get in the swing of it and start buying housing at a discount, there will be another side of the lobby that will say we need more public housing, so we can run it through this discount sale. At some point we should probably consider how you put a lid on any more public housing and just phase it in to go private. The people who get in on the homestead will be the lucky ones, but the next generation will be buying from private developers, et cetera.

Representative KEMP. That could be a problem, but I want to remind you, Mr. Chairman, there are 60,000 public housing units now totally vacant just a drain on the tax base, a drain on the Government, and a drain on the lives of people, and those could be sold off very rapidly to expand the housing stock.

I am for expanding the housing stock, but I think it ought to be done, as you point out by as much private enterprise as possible. That means lower interest rates and you didn't want me to talk about lower interest rates but I'm convinced that if there were any break at all in the interest rate policy of the artificially high interest rate policy of the Federal Reserve Board, we would have in this country close to 2.5 million new housing starts per year.

Now people say that's impossible. It is not impossible. We got it up to 2.3 million in 1983 and very frankly there are millions of turnovers and as those turnovers expands people then have access to more of the stock of housing in this country.

Senator SYMMS. That's right.

Representative KEMP. I remember in 1960 when John F. Kennedy said he wanted to see built in the 1960's some 2 or 3 million new houses in the whole decade of the 1960's, and with interest rates 4.5 percent and the tax cuts of 1963 and 1974 and the growth of the economy, we actually built something like 11 to 12 million new houses in the private enterprise system and frankly we got up to 2.2 million in 1983. It's back to 1.7 million on an annualized basis, but I can't think of a better thing for the poor than to see housing in this country affordable, growing at 2.5 million, and interest rates at which mortgages are closer to single digit, not double digit. But this type of an idea, Mr. Chairman, could really help bring some hope to the aspirations of our citizens.

Senator SYMMS. If we just had a little bit of cooperation from the Federal Reserve our supply side—when you look at what a small part of supply-side economics has really been put into effect, how well it has taken to the market——

Representative KEMP. Interest rates yesterday came down.

Senator SYMMS. It came down how much? How much did they come down?

Representative KEMP. They came down from 11.5 where they had been artificially held for almost 6 months, Mr. Chairman, down to 9. I hope it stays that way. I want to publicly say that there's no reason for the Federal funds rate, the cost of overnight money charged by member banks of the Fed, to be three times the rate of

inflation. Every time the market was allowing them to come down, the Fed was intervening, and selling bonds, and securities, and draining reserves out of the system to keep them artificially high. Yesterday they allowed them to come to 9 percent or maybe 10 percent. Irrespective of that, 100 basis points off of the Federal funds rate is good news. The prime rate dropped in three banks—Wells Fargo, M&G, and Morgan Guaranty—Mr. Chairman, interest rates should be 8 or 9 percent, not 11, or 12, or 13 percent.

Senator SYMMS. Absolutely. The Fed policies have been outrageous, in my opinion.

Representative KEMP. I'm going to debate tax policy.

Senator SYMMS. You're all wound up. I'm sure you're going to do well.

Representative KEMP. Thank you.

Senator SYMMS. Thank you very much. Good luck.

Mr. Butler, did you have any other closing comments you wanted to make?

Mr. BUTLER. Yes. Just let me make two or three points with regard to some of the issues, some of the implications, I think, that come from the British experience.

Let me preface that by saying that I believe Congressman Kemp's bill is a major step in the right direction. Some of the details of that bill, where he draws upon the importance of sweat equity and drawing upon the talents of people within these neighborhoods to rebuild the housing itself, are very, very important ingredients, and the idea of privatization is of course the goal and the inducement to that kind of activity.

Let me just say, as I said, make a few points about some of the issues that arise from the British experience.

I think one difference between Britain and this country that's important to note is the range of incomes that are common within the public housing on each side of the Atlantic.

In Britain, generally speaking, the income level within public housing is not very much lower than the average income levels within the country, whereas in this country in recent years particularly the income levels within public housing are significantly lower than that of the country at large and that has let a number of people, including some officials at HUD, to suggest that the number of people within public housing that could afford to buy their units is very, very small, figures as low as 2 or 1 percent has been mentioned.

But this overlooks some very, very important points, as you will hear tomorrow from Cicero Wilson, and from Kimi Gray of a tenant management group. The effect of providing control through even management, let alone ownership, to tenants in a project has dramatic effects on the income levels within the project, as well as the costs of running that project. When you provide control to the tenants, they begin to use tenants within the projects to provide services and to complete work that previously had been done outside the project. So, income levels tend to rise. As Congressman Kemp said, "We are not talking about a zero sum situation." By transferring the control and ultimately the ownership, you can actually generate higher incomes within these projects, and we have strong evidence and convincing evidence that this is the case.

Moreover, as you will also hear tomorrow, the operating costs of these projects decline as controls transfer to the tenants, for very obvious reasons, that when one owns and controls the project it's in the interest of those tenants and ultimately the owners to bring down costs and to turn off heating when there's nobody in the unit and so forth.

So I think these kind of figures that have been used to suggest that, unlike Britain, there are very, very few people in this country that could afford to purchase their public housing, even at a discount, overlooks these very, very important realities.

I think also it's important to note the difference between the kinds of proposals that myself and Congressman Kemp put forward for home ownership, how they differ from some of the previous approaches.

One of the biggest problems is this country has been with fostering home ownership with those people, is the problem of equity. You almost have a dilemma. How do you require a substantial downpayment to get the kind of effect and commitment you would get in that case, in which case you essentially price out of the market the very people you're trying to aim the program at, or you give a very nominal or zero-equity requirement when it comes to downpayment, in which case people don't tend to have a commitment to their property, and they very often will walk away as soon as the first major repair is needed. But the kind of proposals we put forward I think deal with these issues in two ways. One, the idea of going initially through a tenant management association which already has a commitment to the project itself is very important. And second, the idea of the discount with a recapture provision built in. What this means is that on the first day when the owner takes control of the unit, he is in the position whereby if he were to walk away within a year, he would lose that potential discount that's built into the capital value of his unit. In other words, the discount takes the place of the kind of equity requirement and downpayment requirement which is traditional in most purchases, and, therefore, induces a person who has very little financial equity in the building to stay in that building and stick with it. I think that's a very, very important point.

I think also, again as Congressman Kemp noted, the cost to the Government really has to be examined very carefully and the implications for rental units in general. As I said earlier, many critics have argued that this is a giveaway or that this somehow takes out of the stock very important rental units. Well, for the first reason I mentioned, that by transferring ownership you encourage the maintenance and improvement of buildings, that, in fact, means that you're saving the Federal Government subsidies a considerable amount of money in terms of operating subsidies.

In the manner of the association we will hear from tomorrow, they turned the project which was running a substantial deficit each year into one that was running a surplus and when they went down to the local PHA and provided them with a check for the balance and the PHA didn't know how to deal with it because they never had to face a project that actually ran a surplus. So, it caused great confusion for everybody. I think that's the kind of confusion we can put up with very well.

I think a final point I would make with regard to the rental stock again, as Congressman Kemp pointed out, that there are very important spillover effects from these kinds of approaches. Once you stabilize a public housing project, you can prevent the deterioration of units that will continue in the rental form. So many of those units that are now boarded up because of the condition of the entire public housing project, would come on line by fostering ownership of other units within the same project.

So, I think these arguments that somehow you're going to lose both financially and lose part of the rental stock by moving to the home ownership plan are really red herrings. They miss some very, very important points about the way in which ownership will affect other units within the same areas.

Another point that should be made is that the design of any kind of home ownership plan must ultimately come from the tenants themselves. HUD has just established a demonstration project to encourage home ownership in certain areas and they very correctly are asking the tenants themselves essentially to design the elements of their particular proposal, and then HUD will evaluate it. It's very important to put the initiative firmly in the hands of the tenants themselves because they know the area and they know the special conditions and they know the potential of the tenants themselves for home ownership.

It's also important ultimately certainly to bypass the public housing authorities in this process. The public housing authorities have little incentive to see home ownership developing within their projects, both in terms of the contracts that they now have to service those projects and simply that, as I suspect, home ownership would lead to substantial reductions in operating costs. I think then some very hard questions would be asked of public housing authorities in general as to "Well, if tenants could bring down these costs, why couldn't you?" So one has to be very cautious about the role of public housing authorities in this process.

Maybe a demonstration project would make sense to include PHA's, but as a general rule I think it's important to go direct to tenants in terms of design.

Senator SYMMS. Well, I think that these are good people who are involved in public housing, many of them are very competent, but their incentive is on the other side of the power curve.

Mr. BUTLER. That's absolutely correct.

Senator SYMMS. They have a natural incentive to want to continue with Government housing and Government ownership because then they can be promoted up the ladder. I think there's no question about that.

I had the opportunity yesterday to see a very excellent film that was put together by a foundation where Dr. Walter Williams is the primary host of this film, and he makes some of these same points about his personal experience of being born in the ghetto in Philadelphia, having a father who left home, and a mother raising a large family. Yet his family kept together, and allowed him to end up as a well-renowned Ph.D. economist, because he was able to get a job for $1 an hour and work his way literally out of the ghetto into a better life. With the advent of all of the social programs there's a basic disincentive to allow a person to do that: It forces

people out on the streets and the families disintegrate. He made some very excellent points about it and how the incentive to dismantle some of those programs and return to the privatization process for job training, for education, for many other aspects, housing, what have you—the built-in momentum for more government has to be overtaken and I think you're absolutely right on that point, that we have to go directly to the people who would benefit. The fact is, those Government housing managers wouldn't lose, they would end up moving to the private sector themselves with their experience and knowledge and do the same thing in the private sector, but to do it efficiently.

Mr. BUTLER. I think the incentive of it is really a key aspect of this entire approach, as you correctly said.

Senator SYMMS. Well, Mr. Butler, I appreciate your testimony very much. As I said, your entire prepared statement will be made part of the record, or if you have additional material that you wish to add. We thank you very much for your efforts in this and we look forward to working with you for a continuation of this idea as we start taking the idea and trying to apply it practically to legislation that we might be able to pass through the Congress.

The committee will stand in recess until 9:35 a.m. tomorrow morning.

[Whereupon, at 10:45 a.m., the committee recessed, to reconvene at 9:35 a.m., Friday, September 28, 1984.]

PRIVATIZATION OF THE FEDERAL GOVERNMENT

FRIDAY, SEPTEMBER 28, 1984

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY AND FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, DC.

The subcommittee met, pursuant to recess, at 9:35 a.m., in room SD-628, Dirksen Senate Office Building, Hon. Steven D. Symms (chairman of the subcommittee) presiding.

Present: Senator Symms.

Also present: Edward Abrahams and Steve Hanke, professional staff members.

OPENING STATEMENT OF SENATOR SYMMS, CHAIRMAN

Senator SYMMS. Good morning. The Joint Economic Subcommittee on Monetary and Fiscal Policy will continue the hearings this morning to examine the innovative privatization approaches to reduce Federal expenditures.

This is the fifth in a series of hearings on privatization before the Joint Economic Committee's Subcommittee on Monetary and Fiscal Policy.

Privatization is the transfer of the ownership and consequently the responsibility for supplying goods and services from the public sector to the private sector of the economy.

Yesterday we heard from Congressman Kemp about an innovative proposal to privatize public housing in the United States. I am convinced that this proposal would assist in revitalizing our Nation's cities and, at the same time, it would help the Nation's needy who have been the victims of our Federal public housing programs that were intended to help them. Moreover, given Great Britain's successful implementation of a privatization program for public housing, I also believe that privatization is politically possible.

I might just announce for any of those interested parties in the room that yesterday when the Senate was in session I introduced Congressman Kemp's testimony, and Mr. Stuart Butler's testimony, which were presented to this committee, into the Congressional Record, and introduced a bill to allow for the homesteading of public tenement housing in the United States over into private ownership. The first step has already been taken. We may have to rewrite it a few times and any people who are interested in this cause, we would welcome their input and ideas on how it could be better done for the next Congress. We realize it won't be viable to

pass in this Congress, but we have to get these ideas started so that we can move forward with them.

Now today we are fortunate to have Mrs. June Koch, Assistant Secretary for Policy Development and Research, of HUD, with us to testify about what the Reagan administration is already doing in the field of privatizing the public sector. Also, we have Cicero Wilson, a scholar from the American Enterprise Institute, who will also address the real advantages that have accompanied HUD's privatization program.

So to get the meeting started, our first witness is Mrs. June Koch. June, we welcome you here to this committee. We look forward to having your statement as a part of our record and hearing what the Reagan administration is doing and take your advice as to what we can do here in the Congress to make it work better. So please commence, and your prepared statement will be part of our record. You may either say this in your own words or if you want to read your statement that would certainly be fine also.

STATEMENT OF JUNE Q. KOCH, ASSISTANT SECRETARY FOR POLICY DEVELOPMENT AND RESEARCH, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Ms. KOCH. Thank you very much, Mr. Chairman.

I will submit the prepared statement for the record and I would just like to summarize what is in there. I thank you for this opportunity to appear before you to discuss HUD's proposed public housing home ownership demonstration program.

We are pretty excited about it. We think, as many others seem to be thinking, including Congressman Kemp, that this is an idea whose time has come.

Public housing, as you know, is a major part of our assisted housing strategy. Currently we house about 1 percent of the population in public housing, providing for 1.2 million families. The income level of public housing tenants is fairly low. It ranges from 28 percent of median income, which is about $7,500, but it does go as high as 80 percent of median income, which is well above $20,000; 40 percent of the population is elderly, the rest is families. Of the families, 80 percent of those families are headed by single parents.

For many people in public housing it is a kind of way station. They move in and their income increases and they move out. For others, it's much more a way of life and there are three generations of families living in public housing. For many, even when their incomes rise they continue to live there because they are comfortable with the whole environment and public housing is for them a neighborhood.

In this administration we have been focusing on two things in public housing. One is to improve management. As you know, there are 2,800 housing authorities and most of them are well-managed, but there are several which are not well-managed, among the large ones, and we have been focusing on working together with them to improve that management.

We have also focused on modernizing the stock and since the President came into office we have put in over $7.5 billion in modernization.

One of the things that we think is that money for modernization and the operating subsidies we provide will be money that will not have a long-term impact unless the people who live in public housing have some stake in public housing, are involved in the care of public housing, and feel that it's really their own. And that's one of the reasons that we want to proceed with this home ownership demonstration.

We have worked closely in the past with the demonstration undertaken by my office with tenant management groups. We know that there is a real capability in the tenant management corporations to manage public housing and a real desire to move toward home ownership and that, again, is one of the reasons we are proceeding with this demonstration.

I want to point out that this is not exactly a new concept. At HUD, we have some experience in home ownership of public housing. In 1968, we initiated a program called Turnkey III, by which newly constructed housing was assigned for home ownership under a lease-purchase arrangement. Under that program about 16,000 units were authorized for sale. Actually, only 3,000 were sold and part of the problem we think is that the lease-purchase arrangement whereby the tenant built up equity was hinged to the long-term debt and it took the heart out of many tenants to build up that long-term equity before they could move to home ownership.

Also, under section 5(h) which was added to our basic statute in 1974, public housing authorities have had the authority to sell units to tenants with HUD continuing to pay the long-term debt. Under that section, there have been sales in several cities—New York, Selma, AL; Baltimore, currently Louisville. There have been a lot—perhaps not a lot—but far more applications than we have been approving and we have been responding to those applications on an ad hoc basis with no clear guidelines. One of the reasons, again, we want to run this demonstration is to develop national guidelines to determine what is feasible.

The long-term goal, in my prepared statement, is to provide home ownership opportunities for those who want and can afford it. We think that people in the lower end of the income scale want to, as much as everybody else in the country, have a piece of the American dream—some think the American dream is to own your own house. We would like if feasible, to provide that opportunity.

At the same time, we will continue to maintain the stock for those who cannot afford home ownership and in 1985 we will be providing $1.7 billion for modernization which will modernize something like 300 projects.

The demonstration will require a certain structure, certain events coming together, so that it will not necessarily work for everyone. We are leaving the demonstration very open ended. What we have learned from what has occurred under section 5(h) is that in different cities things work differently.

In Baltimore, for example, single family housing is sold at market price, which can occur in Baltimore because the housing stock has a low price. In New York, it is subsidized with a mortgage provided by the city. In Louisville, which we recently approved, the prices of the units sold are pegged to the income level of the tenants.

So we don't at this point have any specific knowledge of what will work in every city and we are going to allow the proposal and what will work to be developed locally.

We think that not only those who become owners will benefit from this movement toward home ownership, but we think it will have a spinoff effect on everyone living in public housing. Those who have a stake in public housing will have pride in it, will provide the kind of pressures and push toward the general improvement in public housing, that will have a spinoff effect and may affect the 60,000 or 70,000 vacant units currently in public housing. People who own their units will not like living next to vacant units and all the problems attendant upon these kinds of vacant units.

There has been a successful history of sales in Great Britain and a moderate but also fairly successful program in Israel. We have looked at those and we have learned from them, but we think that our program should move along somewhat different lines.

In putting together our demonstration we consulted heavily with tenant organizations, public housing authorities, local governments, and we learned from them some broad parameters of what is feasible and what is not feasible, and we have incorporated that into our demonstration.

One of the things that we have learned—and I'd like to cite those figures in my prepared statement—is a real capability of tenant management corporations to manage effectively. In my prepared statement you will notice that we talk about Boston, the Bromley-Health Development Tenant Management Corp. When they took over the project, a state of disrepair included 4,000 broken windows and all the roofs of all the 37 buildings needed repair. All those problems now have been corrected. There's been a noticeable decrease in crime when the project in Jersey City, the A. Harry Moore, moved to tenant management. Rent collections have been increased. Vacancy rates have been reduced, when the tenants have a stake in running their own projects.

So we think there's been an excellent track record and they have all expressed a desire to move to home ownership.

We issued a "Notice of Intent" in the Federal Register announcing that we would come out with a request for applications in October and we are pretty much adhering to that timetable. We hope the "Notice of Funds Availability" will come out within the next 2 weeks. We will be operating under 5(h). That is, we have the authority to sell the housing and HUD will continue to pay the long-term debt.

Other than that, what the Department will be providing will be technical assistance. We will have national contractors with a range of expertise available and where localities indicate that they would like local technical assistance which they cannot afford we will make small grants available as well.

Now as to the design of the demonstration, we will ask that localities come in jointly with some tenant support group, the public housing authority, and local government. We think it's important that local government be involved because of tax abatement, legal resources, and other resources available at the local government level could add greatly to the home sale.

We are leaving everything else open ended. We are telling the localities that they can determine what the price of the sale will be. In some areas, it will have to be—as in Houston which has indicated interest, they have a State law that public structures have to be sold at market value. In Houston, there will therefore have to be some creative financing, some kind of second mortgage or other vehicle, but the price will obviously have to be market.

In other areas, we can sell as low as $1 or the price can be pegged to the income level of the tenants. The income level of the tenants ready to sustain home ownership again will be determined locally.

We will ask that there be a plan for relocation of tenants who do not want to move to home ownership and we say there can be no forced relocation.

Any kind of home ownership will be considered under this—single housing, single family housing, fee simple, cooperatives, and condominiums. We will ask for a plan to prevent windfall profits. That plan should cover a 5-year period involving resale and recapture of equity.

We will ask the localities to address the question of whether after resale the housing will be kept in some fashion for low-income people perhaps through shared equity arrangements, but they can come in with other proposals as well.

Basically, then, the design is a local design. We are saying that there are really no winners or losers. We will rank the applicants by feasibility and by readiness and we will target technical assistance to them as they become ready. So those who look ready to go immediately, we will work with immediately. As others come on line, we will continue to work with them.

Senator SYMMS. Then you make the decision, is that correct? I mean, the Government makes the decision?

Ms. KOCH. The Government will put together a panel of experts in HUD and bring in outside people as well to help us determine the feasibility and the readiness of those.

Senator SYMMS. Do you think it might be simpler if you just made them available for sale and then let the market dictate that? Those that are ready will come to the table and those that aren't won't.

Ms. KOCH. Let the market dictate what?

Senator SYMMS. Just let the market decide that, so you don't have to have some kind of a bureaucracy built up to figure out who's eligible. Instead, make it like in the Symms-Kemp bill, now introduced, and make a discounted-sale price. They're going to have to pay some so that they have a stake in it. But just dispose of all these millions of units of Government housing that are losing money. Would that be simpler? Could you look at that?

Ms. KOCH. Well, we worry about that for two reasons. One, the legislation that's been introduced, we support that and we think it's an excellent idea. It pretty much copies what's occurring in England, taking market price and discount. In some cases, that won't be feasible, and we think that might rule out home ownership in several cases.

What we would like to do in running this demonstration is to get enough information on what is feasible and what isn't feasible so

that we can develop national guidelines that will work everywhere, and the market will be determining what is feasible. But we want to learn. In some cases, as I say, it will sell for $1. That may work. And in some cases, market may work and may suit the needs of people living there better. But we need to get a clearer sense of what will and what won't work.

Senator SYMMS. Has your information thus far given you any idea of why there are 60,000 vacant units in Government housing?

Ms. KOCH. Well, to some extent, it proceeds from poor management. To some extent, it proceeds from lack of resources, but we are targeting modernization funds to that. There are a variety of reasons for the vacancy rates.

Senator SYMMS. Well, the news media keeps telling us that we are short of Government public housing, yet when you examine it you find out that there's a very low occupancy rate considering the number of units that are empty. What does your research now, after 3½ years of working on this, show you about the occupancy rate of private housing versus Government housing?

Ms. KOCH. I can't at this point give you figures in every locality on occupancy rates in public and private housing.

I have to agree with you that the vacancy rate in public housing is high in some areas, that those vacant units represent a valuable resource. We would like to see, wherever possible and wherever viable, that those units come back online. We think home ownership impetus will have some effect on that. If you talk to tenant groups, they are very concerned about vacant units. They would like to see those units put back in stock because the vacant units become places of encouraging all kinds of people to operate out of there—there are drug operations out of some of them. It generally leads to the whole deterioration of the neighborhood. So we are very supportive of seeing that back online and we hope that we will be working over the next years with the public housing authorities to get those vacant units back online.

Senator SYMMS. Well, I guess my concern is I remember a movie a few years back entitled "The Incredible Bread Machine," and part of the movie was—I believe William Simon gave the introduction to the movie—and part of it addressed housing and urban renewal and pointed out how when the Government decided to go into the housing to provide housing for everybody, that they went in and tore down private houses, forced poor people to move over to worse private houses, rebuilt places that people with higher income levels moved into, and in many cases they ended up with fewer units.

Do you find that to be the case?

Ms. KOCH. I think that that is generally agreed has been the effect of a lot of the Great Society programs. One of the reasons generally within this administration that we have moved away from new construction and to rehabilitation is that we think nationally there is housing available but that the stock has not been brought back to use, and we want to emphasize rehabilitation. You can house people more quickly, more cheaply, from using the stock that is available, both in the private and public sector.

Senator SYMMS. So then, as a general sense, did I here you say you do support the thrust of the bill that we introduced yesterday?

Ms. KOCH. Yes.

Senator SYMMS. If not specifically, but at least in general?

Ms. KOCH. Yes. We may not agree with all the details, and our position on the details is that we would like some time and therefore we're running this demonstration to find out what is feasible, what isn't, what the universe of those who have moved to home ownership actually is. What we have to do at the Federal Government is to facilitate that. Otherwise, yes, we are supportive of the concept indeed.

Senator SYMMS. Well, I appreciate that very much because we are going to need a lot of advice and a lot of guidance on which way to go with this. Congressman Kemp said it pretty well yesterday, that we don't say this is the end-all way this legislation should be written, but we've got to get started and move in that direction. And when you think about the fact that the Reagan administration is already 3½ years through with the first term, there's not too much time left. We've got to do some dramatic things to get this started to point the direction that private housing provides a better opportunity for lower income, less advantaged people than Government housing. And I think the record shows that if we've got 60,000 empty units out there, the taxpayers would be just as well off to have a lottery and give them to people who are disadvantaged. We're not advocating that, but in the long run put those out in private hands so they can fix them up and go into some of those apartment buildings, and own their property inside that, and take some pride in the building, and paint it up, and fix it, do some work like that, and that's much better than just leaving them idle for the rats to infest.

Ms. KOCH. Well, I agree with you on that and we think a home ownership element is a very important part of what we should have in our whole assisted housing program. We should look at it and move to it where feasible.

We don't at this point know if it's totally feasible and our position is that we will continue to maintain public housing stock as public housing and provide modernization funding to bring all of that housing that can be brought back into the stock and to provide operating subsidies.

Down the road, we may discover through home ownership that there are a great many opportunities for this in public housing. Right now, we don't know what the universe is. We know there are several tenant management groups ready to move. We were very pleased when we issued the notice of intent that we got a great many calls from housing authorities, tenant groups, letters from local governments, all indicating a really substantial interest in this program. So there may be a big universe of desire and feasibility out there.

Senator SYMMS. Thank you very much. Did that complete all of your statement?

Ms. KOCH. I think it completes most of the testimony, yes.

[The prepared statement of Ms. Koch follows:]

PREPARED STATEMENT OF JUNE Q. KOCH

Mr. Chairman, Members of the Committee, it is a pleasure to appear before you to discuss HUD's Public Housing Homeownership Demonstration. We are very excited about this demonstration because we believe that the sale of public housing to tenants is an idea whose time has come.

Public housing is a vital part of HUD's assisted housing strategy. The program currently serves 1.2 million very low-income families. A description of the characteristics of these families will help set the context for our public housing demonstration. Public housing consists primarily of elderly and single parent households, headed mostly by women. About one percent of the United States population lives in public housing. Over 80 percent of the families with children in public housing have only one adult in the household. While the average income of public housing families is 28 percent of the median family income for the nation or approximately $7,600, incomes go as high as 80 percent of median or approximately $21,600.

For some families, public housing is a way-station. They move out as soon as their incomes rise sufficiently to afford private rental housing. However, for many families, public housing is a long-term way of life. We know of cases where families have lived in public housing for three generations. Even if these families do have the economic opportunity to move out, they choose to remain because public housing provides their social support system. Public housing is their neighborhood.

HUD's focus has been on improving the physical condition and management of public housing. From Fiscal Years 1981-1984, $ 7.6 billion in modernization funds have been spent on public housing projects to improve their physical structure. During the same period, $ 5.2 billion in operating subsidies have been spent to offset the operating deficits which have resulted in part from statutorily set rents. But these expenditures have not had the full impact they could have had because they have not had the direct personal involvement of tenants. Billions of Federal dollars do not create a sense of neighborhood and long-lasting improvement if the residents feel excluded from the process.

We believe that the participation of residents of public housing in their own neighborhood is essential to long range improvement of the quality of life in public housing. We view public housing homeownership as a way to improve the lives of low-income families and their neighborhoods. We know from experience under the now-completed Tenant Management Demonstration that participating families take pride in maintaining their units. And it means that families in the surrounding buildings and neighborhoods have an incentive to care for their own units.

We have proposed the public housing homeownership demonstration as a way to help families living in public housing take an important step in improving the quality of their lives. It will offer them the opportunity to achieve the American dream of owning one's own home. It will also improve

their neighborhoods, because homeowners have a greater stake in the continued vitality of the area surrounding their homes.

Homeownership for lower-income families is not a new concept. HUD has had some experience with a homeownership program. Since 1968, the Turnkey III program has provided an opportunity for homeownership for public housing tenants. The program has met with limited success, largely as a result of problems in its design. Under Turnkey III, a tenant-homebuyer takes occupancy of a newly-constructed unit under a lease-purchase arrangement, which provides for an initial period of tenancy, and an opportunity to build credits toward equity. A Turnkey III homebuyer becomes a homeowner either when mortgage financing can be afforded and secured, or when balances in the tenant's equity and non-routine maintenance accounts equal the unamortized balance of the development cost for the unit. Until homeownership is achieved, homebuyers must be treated in the same ways as regular public housing tenants. Sixteen thousand units have been authorized for sale, but only 3,000 have been sold. The time period to achieve homeownership and the slowness of equity build-up pegged to long-term development costs have discouraged homebuyers from becoming homeowners.

Under Section 5(h), a key provision of the United States Housing Act which was added in 1974, public housing authorities (PHAs) can sell units to tenants. Under this Section, PHAs may sell units to tenants without discontinuance of the Federal payment on debt service. The Section does not permit the payment of operating subsidy for any unit which has been sold to a tenant.

Only a few PHAs have taken advantage of the homeownership opportunity under Section 5(h). As of July 1984, HUD has approved the sale of 2,951 units, with sales actually consummated for 547 of these units. Baltimore, New York City, and Selma, Alabama, have homeownership programs. However, as we began to consider the need for a larger-scale homeownership program, it became apparent that there was insufficient operational experience about the important issues involved in a homeownership program. We therefore decided to conduct a demonstration using our authority under Section 5(h) to gather this experience and to help groups that were interested in starting local homeownership programs.

Our long-term goal for the demonstration is to provide homeownership opportunities for those who want and can afford it. At the same time we will continue to maintain the remainder of the stock as an important assisted housing resource. The Department has been and remains committed to maintaining and, indeed, improving the viability of our Nation's public housing. We will continue to provide Comprehensive Improvement Assistance (CIAP) funds and operating subsidies for the public housing program. For Fiscal Year 1985, we will provide $1.7 billion in budget authority in CIAP funds. This will result in $86 million in contract authority for the modernization of approximately 300 projects. We will also provide $1.14 billion in operating subsidies.

We recognize, of course, that this demonstration will not work for everyone. Only certain projects will have all of the elements necessary

for a successful homeownership program--a cooperative PHA, an active local government, a suitable building or complex, tenants who can afford the cost of homeownership, and most importantly, a group of tenants who understand the responsibilities of homeownership and can carry the plan to fruition.

The purpose of the demonstration is to provide information on the need for and feasibility of a fully-operational homeownership program. We will be looking at different approaches to homeownership to determine what works well. In addition, we will be producing guidelines for a homeownership program, something that has been missing from HUD's previous homeownership efforts, so that other interested sites can develop homeownership programs.

It is important to note that developments converted to homeownership will still be serving low-income families. The only difference is that these families will be owners, not renters. Homeownership opportunities will be part of our overall strategy for dealing with the housing needs of low-income people, not only through the public housing program, but also through vouchers, and the Section 202 and Rental Rehabilitation Grant Programs.

As mentioned earlier, there will be "spin-off" effects that will result from a homeownership program. We know that there are many vacant units in public housing today which should be a housing resource, but are not.

Homeownership and other improvements in the public housing environment we will be discussing later will help upgrade the local image of public housing and provide an incentive in the surrounding neighborhood so that fewer units fall into disrepair and become vacant.

We have looked at the experiences of other countries in developing our homeownership demonstration. Both Great Britain and Israel have implemented homeownership programs. In Great Britain, over 800,000 public housing units, or approximately one-eighth of the total public housing stock, has been sold over the period 1970-1983. The relatively large scale sale of public housing reflects the Conservative Party policy of relying on market mechanisms for housing as much as possible. In Israel, approximately 15,000 units have been sold. The identification of significant differences between foreign and U.S. public housing has helped us understand the need for a different approach than that taken by other countries.

Tenant associations, PHAs, and local governments have expressed an interest in a larger-scale homeownership program. In recent weeks we have talked to many groups interested in homeownership. What they told us was that they needed help in developing various types of sales approaches and in making a sales program work.

In developing plans for this demonstration we were impressed with the interest and capacity of public housing tenants to shape their destinies. Tenants have joined together to improve their lives.

Tenants have learned how to successfully manage their developments. Under a HUD-sponsored Tenant Management Demonstration, which ran from 1976 to 1979, tenants proved that they had the capability to manage their projects. The five tenant management corporations which participated in this demonstration showed that they could produce substantial benefits in terms of increased rent collections, lower maintenance costs, and, most importantly, a sense of personal development among participants. It has been several years since the end of the demonstration and most sites have continued tenant management successfully. In addition, there are now tenant management corporations running developments in seven other cities.

Some examples of actual activity help demonstrate how successful these corporations have been. For example, the tenant management corporation operating the Bromley-Heath development in Boston has turned around one of the worst public housing projects in the country and has increased rent collections, decreased maintenance costs, and lowered vacancy rates. When the Tenant Management Corporation took over running the project there were 4,000 windows broken and the roofs of all 37 buildings in the development needed repairs. All of these maintenance problems have now been corrected. The tenant management corporation operating the A. Harry Moore development

in Jersey City has made significant changes in the physical condition of the property and has achieved a notable record in reducing the project's crime rate. The tenant management corporation which operates the Kenilworth/ Parkside development here in Washington, D.C. has increased rent collections 130 percent over what the PHA was collecting. The tenant management corporation at the B.W. Cooper Homes in New Orleans had even more success at increasing rent collections. Since taking over the project, they have increased collections by 300 percent. Vacancy rates at another tenant management corporation project, the Iroquois Homes development in Louisville, have dropped from 18 percent to one percent.

Tenants have also created economic development opportunities for themselves. The tenant management corporation managing the Kenilworth/ Parkside development has had considerable success in setting up small businesses and cooperatives, such as a laundromat, food market, and a barbershop, as a means of providing needed services and also generating and assuring revenues. Several of these tenant management groups have also indicated an interest in a homeownership program.

HUD's public housing homeownership demonstration will provide a national focus for the various groups interested in local sales programs. It will also provide a basis for further expansion of the concept to a homeownership program that can be used at varying sites and in different types of localities across the country.

We have developed the guidelines for the demonstration, which will appear in a Notice of Funds Availability (NOFA) to be published in the Federal Register shortly. We chose to leave most program details to local definition. The demonstration encourages a wide variety of local approaches to the sale of public housing to current tenants. Conventional sales, cooperatives, condominiums, and lease-purchase arrangements in single-family and multifamily projects can all be offered as forms of homeownership. Units proposed for sale must be in sound physical condition or currently approved for rehabilitation.

The major requirement we have placed on the demonstration is that the families who purchase their units must be able to afford the full costs of homeownership without any Federal subsidies. This means that purchasers must be able to pay for any mortgage, taxes, insurance, and regular and extraordinary maintenance.

By law (under Section 5(h)), the sales price can be set as low as $1, in order to make the sale affordable. HUD will still continue to pay the debt service and previous modernization costs after the project is sold, but is not permitted to continue paying operating subsidy. Thus, purchasers will be responsible for all housing expenses incurred after sale.

Besides continuing to pay the debt service, HUD's other financial contribution to participating local sites, will be to provide technical

assistance, tailored to each site's unique local needs, for implementing the project. This technical assistance can either be provided directly by a national contractor to be hired by HUD or through small grants used to purchase local technical assistance.

Participating sites must submit a plan on relocating any tenants who choose not to, or are not financially able to, participate in a sales program for their building or complex. We will not permit the involuntary relocation of tenants.

We are leaving all other issues such as the sales price, the mortgage financing vehicle, the interest rate, and the sales mechanism up to local determination. Let me explain in more detail why we think this is the only way to go about developing a homeownership demonstration. We looked at the PHAs currently developing homeownership programs and found that they had developed program requirements to meet the goals they set for the program. Each program reflects local thinking about how a homeownership program should work.

Thus, in Baltimore the sales price is set at the fair market value because the PHA wants to run a sales program as close to a conventional sales program as possible. Such an approach is feasible in Baltimore because of the very low price of some of its housing stock. In Louisville,

the sales price is based on a predetermined standard amount, based on unit size, because a key objective in Louisville is to make homeownership possible for lower-income families at various income levels.

Another example of the benefit of local determination of how the demonstration will work is what kinds of sales vehicles PHAs are using. New York City, under its Project HOME, which has been in operation since 1977, is selling one- and two-family FHA-acquired properties to tenants. Louisville, in its College Court project, will be selling the units as condominiums. Some tenant management corporations are promoting the sale of buildings to their associations, with a subsequent phase-in of sales to tenants, as they become able to afford homeownership.

Let me give one final example to bring home the point. In Baltimore, the homeownership program is using conventional mortgage financing, again to produce a program similar to a conventional sales program. In New York City, the PHA is providing the mortgages directly because of the administrative simplicity of issuing their own "paper."

As these examples demonstrate, there is no one "right" way to run a homeownership program. Local flexibility must be an integral part of the demonstration if we are to make it possible for tenants to move successfully from renter to owner status.

Local flexibility is also necessary if we are to resolve some of the very difficult and complex issues involved in selling units to tenants. For example, concerns have been expressed that tenants purchasing units will receive windfall profits when they resell their properties on the private market. The demonstration requires a recapture of equity provision for a five-year period after the initial sale, but allows applicants to define the recapture mechanism and what will happen after the five year-period has ended. Some applicants will believe that homebuyers are entitled to reap equity increases just as conventional homeowners are. Others will believe that there should always be limited equity sharing (for example, through a cooperative). We will be working with tenants, PHAs, and the communities to help them work out this issue.

There have also been concerns that property values will increase so much that lower-income families won't be able to repurchase them when the original homebuyers sell, thus removing the units as a low-income housing resource. The Notice of Funds Availability (NOFA) asks applicants to address this issue, because it is an important one. The NOFA suggests that limited equity cooperatives are one arrangement that would serve this purpose, but encourages the development of other approaches.

The public housing homeownership demonstration will be different from other HUD programs in another way. Most programs are initiated by a public or quasi-public agency. For the homeownership demonstration, the program

can be initiated by the public housing agency, the local government, or by a tenant association. However, since the demonstration can be successful only if all three parties are actively involved, we are asking each of them to have a stake in the project.

Another unusual feature of this demonstration is that it will not have a "fixed" start date for all sites. The Notice of Funds Availability will be published in the Federal Register in early October, with applications due in early December. Selection of sites will begin shortly thereafter. Sites will be able to enter the demonstration as soon as they are ready to begin implementation of their local homeownership programs. Because we believe that homeownership is so important, and because we want to have as many sites in the demonstration as possible, we will not have winners and losers in the selection process. We will be working with each applicant to assist them in designing a homeownership program that is both feasible and appropriate for their local situation.

Once the demonstration has begun, we will work actively with participants to ensure that homeownership becomes a reality. We will provide technical assistance in such areas as: preparation of legal documents required for sale; financing techniques; counseling to tenants on homeownership responsibilities; training in property maintenance; and training in cooperative or condominium forms of ownership. We will also provide for an information exchange among the sites and between the sites

and groups not in the demonstration who are interested in starting a homeownership program.

The Public Housing Homeownership Demonstration is one of several projects which has been developed by the Reagan Administration which helps families achieve economic independence and improves the quality of life for lower-income families. One such project is Project Self-Sufficiency, which offers single parent households a comprehensive package of job training, "survival skills," counselling, child care, housing in the form of Section 8 certificates, and job placement assistance.

Another demonstration project is the Minority Youth Training Initiative, which is providing young people who live in or near public housing projects in 18 communities with the education and training to get a job and job placement in a permanent job through a joint effort involving HUD public housing modernization funding and local Department of Labor Joint Training Partnership Act funds. These youth will be trained and then placed in jobs related to the management, repair, and maintenance of housing.

As with the public housing homeownership demonstration, these projects encourage the development of local programs tailored to local solutions. Other demonstration projects to improve the quality of life for lower-income families are also being planned.

In conclusion, we view the public housing homeownership demonstration as a means to provide lower-income families with the opportunity to improve the quality of their everyday life. Through homeownership, these families will not only be a part of mainstream America, but will also ensure the continued vitality of their neighborhoods. The public housing homeownership demonstration is an important rung in their ladder of opportunity.

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Senator SYMMS. One thing that you have said in your prepared statement here that I noticed is the concern that property values will increase so much that low-income families won't be able to repurchase when the original home owners sell. I was thinking that if we could have some kind of a system where people could purchase their homes and make them affordable for at least the first entry so they could get started, then you would eventually develop a capital base for those families. They would work and acquire a position so they could in turn sell to someone else; as they take that capital out and move into better housing, it would work just the opposite of that.

Do you agree with that or did I misunderstand?

Ms. KOCH. I think what you're proposing is feasible. We would, however, like the localities to address this issue. I have been told by some tenant groups that they feel that they can also manage private housing, that some of what they make from that management will help subsidize resales to keep the cooperative they're setting up to public housing for lower income, that high-income tenants will support lower. There are lots of ways to look at this and we think that each locality can develop its own program and its own proposal for how to deal with it. Certainly the one you mentioned is one way to deal with it.

Senator SYMMS. Well, I think from a humanitarian aspect of it that if a family is a working family in the low end or in some cases partially supported with a Government subsidy, if they always are just paying into the Government tenement for rent and never accumulate a position of any capital, they can never gain any substance in the property and then they never feel like they can get ahead. Everything that they get in terms of income is used for consumption. Maybe they can save some, but they have a difficult time accumulating enough for a downpayment. And this seems like one way to encourage savings and a recognition of the necessity for everybody, no matter what level of income they're at, to save something. And this is a way that it would work, which encourages those kinds of traits that have really built this country.

Ms. KOCH. Well, I agree with you. It will allow them to build up equity. It will give them a stake until they feel they can move on and be part of the regular economy as well.

Senator SYMMS. Well, thank you very much. We appreciate your testimony. We will look forward to working with you on this, June.

Ms. KOCH. Thank you.

Senator SYMMS. The next witness is Cicero Wilson, from the American Enterprise Institute. Welcome to the committee. Do you have a prepared statement?

Mr. WILSON. Yes; I'm going to have copies brought over. I've been on the road and I just got in a few minutes ago.

Senator SYMMS. OK.

STATEMENT OF CICERO WILSON, RESIDENT FELLOW AND DIRECTOR, NEIGHBORHOOD REVITALIZATION PROJECT, AMERICAN ENTERPRISE INSTITUTE, WASHINGTON, DC

Mr. WILSON. First, I'd like to thank you for the opportunity to testify before this committee. The views I will be presenting are my

own and do not necessarily represent those of the American Enterprise Revitalization Institute.

I am the director of the Neighborhood Revitalization Project at AEI and for the past 4 years we have been conducting studies of indigenous neighborhood groups involved in community development.

One of the more interesting models that we have looked at is right here in Washington, DC, the Kenilworth Parkside Resident Management Corp. It's been receiving quite a bit of publicity. I'd like to fill in some of the details about why it is an excellent model and, then, what type of impact this model should have on any plans to privatize public housing or to look at home ownership for public housing residents.

Kenilworth Parkside is a 25-year-old, low-income public housing complex in northwest Washington, DC. Until recently the community was overridden with drugs and crime. The units received no heat or hot water for almost 3 years between 1979 and 1981. Teenage pregnancies were frequent, and 85 percent of the families relied on transfer payments for a major portion of their annual income. Approximately 30 percent of the families were totally dependent on welfare for their support.

In 1982, the residents, through the resident board and a newly created resident management corporation, began to manage the 464-unit complex. Specific housing management training was provided through a grant by the District of Columbia. The resident's experience fighting the former management firm and running social service programs also prepared the residents to assume management of the complex.

Their success has been outstanding. In the past 2 years, Kenilworth has reduced teenage pregnancies by 50 percent, reduced welfare dependency by 50 percent, reduced crime by 75 percent, and increased rent receipts by 130 percent, from $36,000 per month in 1981 to a new level of $83,000 per month currently.

In addition to the tremendous increase in the rental receipts, the resident management corporation also reduced administrative and operating costs. Referring to one of the tables in my prepared statement entitled "Per Unit Monthly Cost Comparison," the resident management corporation reduced administrative costs by 64 percent in the first year of operation and 60 percent in the second year. That's in comparison to the cost of the previous management firm, using 1981 as the base line. Ordinary maintenance costs were reduced by 26 percent in the first year and 20 percent in the second year in comparison to the base line.

Kenilworth is generating enough rental revenue to pay all of its $440,000 a year in operating expenses and it can handle 90 percent of the approximately half a million dollars in energy costs each year. If adequate investments were made in upgrading the heating plant and insulation of these 25-year-old units, the resident management council could reduce energy consumption by 20 percent.

Senator SYMMS. How many units is it?

Mr. WILSON. 464. The energy estimates are based on an audit done by the D.C. government and a separate audit done by Pepco at our requests. Obviously, with this type of substantial reduction,

Kenilworth Parkside would then be in a good position to realize a profit from managing the complex if they had title to the property.

The resident management corporation was able to bring about this small miracle, first, by instilling a greater sense of social responsibility among the residents. Residents were educated about their responsibilities to respect their neighbors, to keep their units and grounds clean, to reduce damage due to vandalism, and to pay their rent on time. Part of the residents' social responsibility included helping themselves and their children improve their skills and earning capacities. It is not acceptable to collect welfare and watch soap operas all day at Kenilworth. There is a strong self-improvement ethic at work at Kenilworth.

Second, the resident management council and the resident management corporation assists families to increase their incomes through job training, job creation, and a network of social services designed to facilitate participation in the labor force. The resident council operates training programs for 80 adults and youths at Kenilworth and a postsecondary assistance program which has sent 480 youths to colleges and technical vocational schools in the past 10 years. The resident management corporation has created 120 jobs through 6 new businesses and 2 joint ventures with private firms.

The heightened responsibility of the residents has increased their participation in all of these self-improvement services and enterprises. This, in turn, increased their earnings and thus provides adequate rental income and consumer spending power to manage the units and support new businesses.

Referring to another table, "Resident Income," I think this is the key. If we're thinking of bringing in private firms to manage public housing but still do not have enough rental income to cover expenses and to realize some profit, I'm not sure that the idea will work. But if you look at the resident income from all sources at Kenilworth, it's increased by 9 percent, from $2,287,000 to $2,548,000.

More importantly, while overall income is rising, the increases are due to more income from work and less from welfare. Income from work has increased by 27 percent.

Senator SYMMS. Could I ask you a question right on that point, so I can get this straight, since I don't have your statement to follow.

The Kenilworth housing unit was publicly owned?

Mr. WILSON. Still is.

Senator SYMMS. But it was taken over by a private management concern?

Mr. WILSON. Yes, this private management concern is the resident management corporation made up of the tenants at Kenilworth Parkside. They basically got the property by default. The old management firm quit. They weren't being paid by the District of Columbia government. The heat and hot water had been off for 3 years. They weren't realizing a profit. So when it was time to renew their contract, they walked out.

In the next 2 months, during the time that the District was deciding what it was going to do, the residents organized, put togeth-

er a corporation, and started collecting rents and managing the property themselves.

Senator SYMMS. It's kind of like a cooperative in a sense?

Mr. WILSON. Yes.

Senator SYMMS. People who live there are part of the management?

Mr. WILSON. That's right.

Senator SYMMS. So, in other words, they are applying the market system and principles of private ownership to the management of Kenilworth?

Mr. WILSON. Yes.

Senator SYMMS. And it's the same people who are living there?

Mr. WILSON. Yes. There were only two evictions during this period.

Senator SYMMS. What's the explanation for the fact that the income has gone up?

Mr. WILSON. Well, they basically put together a very extensive network of job creation activities and job training, and there's a real push. There's a social ethic there that you have to improve yourself. It is not really necessary to evict poor-paying tenants if you can reeducate them and get them to pay their rents on time.

Senator SYMMS. In other words, what's happened out here right under the shadow of the Capitol almost, despite criticism that the establishment news media would point out that private ownership is bad for the poor, it's actually been good for the poor in this case?

Mr. WILSON. Well, with certain conditions, and I think that's why it's important to look at the Kenilworth model. I think certainly that if you're putting in an arrangement where residents have a tremendous involvement in the management, it can be through a resident management corporation. It can be through a joint venture by the residents with equity participation between the residents and a private firm.

Senator SYMMS. Who's got the fee title to these 464 houses? Are these houses or are these apartments?

Mr. WILSON. They are low-rise apartment buildings.

Senator SYMMS. Who has the fee title to these?

Mr. WILSON. The District of Columbia.

Senator SYMMS. Is there any effort being made to purchase that by the resident management corporation?

Mr. WILSON. Yes, they have——

Senator SYMMS. Maybe you were getting to that.

Mr. WILSON. No, the question is leading to the same information. The Kenilworth Parkside residents have had home ownership as a goal for quite some time. Even though they had no real plan to implement that goal. They did have a 4-acre parcel where they wanted to build 20 townhouses and they basically told the residents that the most responsible residents would have the first option for moving into these homes once they were available. That's really helped increase the rent payment because timely rent payment is one of the criteria for home ownership opportunity. They use the same criteria that anyone else who's going to be selling a home uses:

Did you pay your rent or your previous mortgage on time?

Their rent collection rate went from 65 percent to 98 percent and it stays between 98 and 99 percent. That's for the last 2½ years. The home ownership incentive is one of the most powerful incentives in terms of getting people to pay.

So I think that in terms of the criticism of the private sector being involved with this type of management, what the residents there have done is to get advice from the private sector on what are the basic principles of real estate management, what should we be doing. They have an extra punch in that they are able to take a woman who's on welfare and created a job for that woman. They won't send her through a big social service bureaucracy. They will create a job right there. They have created over 120 jobs there. They have 23 jobs in the resident management corporation itself, the clerk's jobs, the groundskeeping jobs, et cetera, which basically pay on average $7,800 a year. That's in comparison to a woman with two dependents on AFDC who receives $3,599 annually in the District. So you're basically doubling that person's income. But in return for having access to that job, there are all sorts of other things that the resident has to do as a good neighbor or a good citizen in that community.

So they created a catalyst. They take some of the worst cases and give them opportunities. They take the best cases and give them opportunities. It sort of creates pressure on everybody to move forward.

I think that one of the key misconceptions about public housing is that you have to have much higher income families living there in order for it to work. At this point Kenilworth still has one-third of the families paying under $100 per month. In fact, there are two rents that are $6 and $7 per month. So it is not that they have changed all of the family incomes. They have changed a significant portion of them, but everybody does their fair share. Everyone is paying their rent on time, whether it's $6 per month or the highest rent which they have, which is $775 per month. Now that person paying such high rent obviously is staying there because of some options that he or she hopes will be exercised in the future for home ownership or the townhouses and also because there are other services there. There's a career ladder. There's an opportunity ladder in place in this community.

For example, one woman has been on welfare for 11 years and her daughter had had a child at 15. The daughter had dropped out of school. They put the girl back in school. They encouraged her to go to postsecondary school. She went to a cosmetology school. When she finished, they gave her space at Kenilworth Parkside to open up her beauty and barbershop. She is now employing six other youths who are also in training. So it's that type of chain reaction.

Unless you have that network of social services, a job creation capability, and then good management practices, I don't think that the type of increase in income that makes the privatization of public housing more feasible can occur.

You can, of course, take a hard line, which the resident council and the resident management corporation take at Kenilworth. They have certain rules with little catchy phrases like "If you're convicted, you're evicted." They fight with legal services lawyers

all the time about not making Kenilworth a place of last resort for people who don't respect their neighbors and who aren't attempting to improve their condition.

I'll skip ahead to the major recommendations that I would offer. First, the resident involvement has to be a standard feature of any model for privatizing the management of public housing. Preferably residents should be involved through an elected resident council and a separate resident management corporation. The corporation should manage the property after proper training on its own or in equity partnership with a private property management firm.

Second, modernization funds should be used to upgrade the properties before a private sector organization is given responsibility for management. That's absolutely critical at a place like Kenilworth, which has a tremendous energy bill, an unrealistic one, which is based on the fact that when it was built no one was energy-conscious. We were doing the energy audit and when we took the plate off the wall there was absolutely no insulation. It's cinderblock underneath it.

Senator SYMMS. That's a good point. In other words, you're saying that first off you've got to have the association, the home owners association, to get it started. That would be the first step prior to privatization.

Mr. WILSON. Yes; you have to have the tenants there.

Senator SYMMS. We have that in our bill, so that you're not trying to palm off a dilapidated piece of property, but that it would be ready to operate when it finally makes that step into the private sector. Go ahead. I don't mean to interrupt. Those are very good points, I think.

Mr. WILSON. Then the other caution that I think is really important is that in selecting the private firm—and this is why I wholeheartedly support the way HUD is moving forward with their demonstration—there's a lot of information available on how to make this thing work and it must be considered. We have a track record over the last 20 years of taking a good idea and throwing it out into the field before we've really thought through some of the fine points. As a result, we have had partially successful programs that get thrown out—the baby gets thrown out with the bathwater.

I think the way that HUD is planning on doing its demonstration and collecting the information is excellent. It's really a formative evaluation. It's not an idea that I think this administration is going to give up on or that your committee is going to give up on any time soon. The point is that if we understand where the mistakes are and how to correct them, there's more impetus to go on. In the past, we have done programs, not evaluating them properly, so it didn't work and we didn't know why and, therefore, people said, let's forget it and look for another panacea.

I think that one of the things that the Kenilworth experience really suggests to me is that we have to be really careful about making sure that there is some way to improve the social and economic climate in public housing at the same time you're improving the management. I do not feel that excellent management by itself or an exemplary social service network by itself will turn around the situation in public housing. You can put—there have been very good managers who have tried to take over public housing units

and have failed. I think that's partially because they were working against the residents there. I think resident participation has to be a key feature.

The other thing I should point out is that the deplorable conditions at Kenilworth were basically the result of the District of Columbia and a private contractor. So that, in a sense, it was a partially privatized operation, although they weren't in a position where they were trying to protect their investment, keeping up the property and maintaining a rigorous maintenance schedule, et cetera, because they knew that they could move on if it got too bad. They would suck out whatever profits they could and move on.

I think that both the way the bill is structured and the way that HUD is considering its demonstration, there are real economic incentives for whoever is in the ownership position. I would say, though, that it will not work unless the residents are involved in that aspect. They have to have an equity position.

The other thing I'd say is that if we're talking about stabilizing these distressed communities with public housing, the example of Kenilworth—where they have basically decreased welfare participation by 25 percent and decreased the number of families totally dependent on welfare payments by 50 percent—establishes a prerequisite for these home ownership initiatives to work in the outyears: There has to be rising family income.

Senator SYMMS. Of course, that's a hidden factor that's involved when the Government numbers people look at these things. What you're talking about is the dynamics of having these people become self-sufficient and not tax-takers but taxpayers, and in the process gaining an enormous step forward with respect to their own dignity.

Mr. WILSON. Right.

Senator SYMMS. And it can change things for generations instead of just the short-term. So the investment is well worth the upfront money that it would require.

Mr. WILSON. I think that is one of the ways I would put it, and I argue with a lot of people about this. We should not be in the business of creating permanent low-income communities, whether they're public housing or whether they're neighborhoods. If we set up the right incentives—and home ownership is the most powerful incentive we have—then we don't have to settle for a permanently subsidized low-income neighborhood.

Now Kenilworth if it ever gets the opportunity at home ownership, does intend to keep the door open to poor families. It is not that they do not want an intake process, but what they do want is to transform the families. The new families that come in have a tendency to be involved with drugs, have a tendency to be involved with welfare, and what the established residents do is change that behavior with a unique blend of sanctions and incentives. That's why they've only had two evictions in the last 2½ years. Many people have said, "Well, sure, they probably threw the problem cases out." They don't. They change them. They transform them. I think that really should be the goal that we're aiming at.

The other thing that's important is there are an awful lot of things that are working out there in the private sector with regard to affordable home programs around the country. We have not

tried to apply that same methodology, those same program strategies to public housing because we feel that everyone in public housing is a basket case beyond help. I think that it's important that HUD is basically acknowledging the fact that there is potential present among public housing residents, that people there have aspirations just like everyone else to have a good job, to be able to own their own home, to be able to stand on their own two feet.

What we have here is a model that's been very successful in doing that. So it's not a pipedream. I invite people who don't believe it to go out to Kenilworth. I took a reporter from CBS out there a few months ago and the first thing that he noticed was that the grounds were cleaner than the neighborhood he lived in in northwest Washington. So I think there's a visual, concrete example here on how to move forward with this, and I would hope that Congress and HUD can stay in step on this because we don't get too many opportunities to see good legislation come out. I think this is a very good piece of legislation, but I wouldn't want to see it go up in smoke because it moves too quickly.

Senator SYMMS. Because it moved too fast or didn't get all the bugs worked out?

Mr. WILSON. That's right.

Senator SYMMS. I think that's an excellent point. That's one of the reasons, of course, we're having these hearing in this committee. The Joint Economic Committee has no legislative authority. So we can build a case on the idea base and then this has to be worked out by the respective committees. In this case, it would be the Banking Committee that would deal with public housing. I think that's probably a good point that you make, that it is so critical to the future of the United States to revitalize the inner cities. Those of us who come from areas where we don't have inner cities have a stake in this because of what kind of a potential it provides for us who are on the producing end of raw materials that are used in the inner cities, the farm, wood products and other products we want to market. If we develop a larger viable economic constituency, then we have developed a market for those people from other parts of the country to deliver goods to sell to them. And I think definitely all Americans have a stake in this and I really look forward to working with you and your input on what we can do to bring this thing about.

I think projects like Kenilworth are a good step, and the demonstration project that June Koch talked about, to get some examples out here where it can actually work. That's a real positive factor.

Mr. WILSON. I think there are three potential criticisms that you're going to run into with the bill and HUD is going to run into with the demonstration. One is going to be this belief that the residents really don't have the capability of handling this. Well, many of the most successful community development ventures have been done by indigenous neighborhood groups that are not very sophisticated in business, but are very sophisticated in terms of improving social conditions and improving the economic climate within their neighborhood. They go into a joint venture with private firms. So, I think the issue is whether there is a partnership that has all of the relevant expertise, both on the social and community side and on the real estate or business management side, and not whether the

tenants alone in any particular city have the wherewithal to handle running a public housing operation.

I'd just like to respond to one question that you posed to June Koch about the reason for the vacant units.

I'm studying distressed communities in 12 cities and the vacancy rates in public housing units are basically in the large multifamily dwellings and they are in major cities. I'd say 10 or 15 of the major cities are the big culprits—the Detroit's and Philadelphia's in particular.

When I interview residents in these communities, what they say is that the vacant units are where their daughters get raped, where the arsonists start their fires, where the drug addicts shoot on, and where the drug traffic sort of centers.

Public housing authorities are paid subsidy for vacant units the same as they are paid for occupied units. So that if they take those off the market and do not have to conduct routine maintenance, they are making a bundle by boarding of Herman Gardens in Detroit.

Senator SYMMS. Who's getting paid for that?

Mr. WILSON. The public housing authorities receive a subsidy for that. Now the National Tenants Organization——

Senator SYMMS. So then they transfer the money to some other form of the Government?

Mr. WILSON. Yes, and in every city where there's a horrendous problem with vacancy rates in multifamily dwellings, there is usually at least a 5,000-person waiting list for public housing. So, when you have thousands of units that are vacant and the public housing authority is being paid for those vacant units, there are also thousands of people waiting for those units——

Senator SYMMS. I wonder if GAO has ever audited some of those.

Mr. WILSON. I have no idea, but I tell you, if you look at the aggregate statistics, it looks like a small number of vacancies. The vacancy rate in a place like Detroit is probably 2 or 3 percent. I have the figures somewhere. But if you look at the multifamily dwellings, it's 55 percent. That's where the problem comes in.

Senator SYMMS. It's a classic example of socialism at work.

Mr. WILSON. Well, I don't know whether I'd go that far. I would make my first stop on inept local government bureaucracy before I would go that far.

Senator SYMMS. The point is, they take the money from the taxpayers and it's sent to Detroit under the guise that it's going to subsidize housing for people who need it; and the people who need it are waiting in line. And the local entity of government takes the money and transfers it into some other thing to buy more votes from the same people standing in line waiting for the housing, and telling them that they're still working on it.

Mr. WILSON. That's right.

Senator SYMMS. If we could get it where——

Mr. WILSON. I think the other point is that if you put the modernization money into the public housing home ownership effort, people are basically going to complain that you're creating a sweetheart deal for private contractors, whether it's the resident management corporation or whether it's a private real estate management firm.

The problem with the modernization funds now is that they go into a public housing authority based on a squeaky wheel theory, and that if it's really delapidated and falling down and there's an exposé in the paper, we'll put $5 million in to shape it up. Of course, we've done nothing to change resident behavior or management procedures, so that in 2 years it looks just as bad as before you put the $5 or $6 million in it.

I think by targeting the modernization funds with the public housing home ownership, you accomplish what the modernization program should do, which is to upgrade and have a permanent, long-lasting, positive impact on the condition of the facilities. And I think that's one that you're probably going to run into from the council of large public housing authorities which may be concerned about how those modernization funds flow.

There was one other comment, but it escapes me, but I will be releasing this report soon. I thought it was going to be ready today, but we will be sending over copies of my prepared statement this afternoon.

Senator SYMMS. Good. Well, your prepared statement and testimony will be part of our record. I'd like to keep close coordination with you, the American Enterprise Institute, and this committee so we can call on your experience for guidance. We should try to work with HUD also, so that we can, in fact, keep the Congress in the front edge of some of these ideas in the private sector.

[The prepared statement of Mr. Wilson follows:]

PREPARED STATEMENT OF CICERO WILSON

THE KENILWORTH-PARKSIDE RESIDENT MANAGEMENT CORPORATION:

AN EFFECTIVE EXAMPLE OF PRIVATIZING PUBLIC SERVICES

Mr. Chairman, thank you for the opportunity to testify before this committee. The views I will be presenting are my own and do not necessarily represent those of the American Enterprise Institute.

The Kenilworth-Parkside Resident Management Corporation is an experiment in privatizing the management of public housing and developing self-sufficiency for low-income welfare-dependent families. The tremendous improvements in social and economic conditions at Kenilworth are a result of good management, effective social controls and real economic incentives. It is a replicable model which can be successfully implemented in other distressed communities and public housing complexes.

Kenilworth-Parkside is a 25-year-old low-rise public housing complex in northeast Washington, D.C. Until recently the community was overridden with drugs and crime. The units received no heat or hot water for almost 3 years between 1979 and 1981. Teenage pregnancies were frequent and 85 percent of the families relied on transfer payments for a major portion of their annual income. Approximately 30 percent of the families were totally dependent on welfare for their support.

In 1982 the residents, through the resident board and the newly created resident management corporation, began to manage the 464-unit complex. Specific housing management training provided by the District of Columbia and the residents' experiences fighting the former management firm and running social service programs (i.e., day care and college/post-secondary training programs) prepared the residents to assume management of the complex. Their success has been outstanding. In the past two years, Kenilworth has reduced teenage pregnancies by 50 percent, reduced welfare dependency by

50 percent, reduced crime by 75 percent, and increased rent receipts 130 percent from $36,000 per month in 1981 to $83,000 per month currently.

In addition to the tremendous increase in rental receipts, the KPRMC also reduced administrative and operating costs. Referring to Table 1 "Per Unit Monthly Cost Comparison," the KPRMC reduced administrative costs by 64 percent in their first year of operation and 60 percent in the second year in comparison to the costs of the previous management system baseline in 1981. Ordinary maintenance costs were reduced by 26 percent in the first year and 20 percent in the second year in comparison to the baseline. Kenilworth is generating enough rental revenue to pay all of r its $440,000 in operating expenses and 90 percent of the approximately $500,000 in energy costs. If adequate investments are made in upgrading the heating plant and insulation in these 25-year-old units, then the KPRMC could reduce energy consumption by 20 percent and realize a substantial profit which could be used to create more jobs for residents.

The KPRMC was able to bring about this small miracle by: First, instilling a greater sense of social responsibility among the residents. Residents were educated about their responsibilities to respect their neighbors, to keep the units and grounds clean, to reduce damage due to vandalism, and to pay their rent on time. Part of the residents' social responsibility included helping themselves and their children improve their skills and earning capacities. It is not acceptable to collect welfare and watch soap operas all day. There is a strong self-improvement ethic at work in Kenilworth.

Second, the KPRMC and the resident council assist families increase their incomes through job training, job creation and a network of social

TABLE 1

PER UNIT MONTHLY COST COMPARISON

	Conventionally Managed (In Thousands)	Tenant Managed (In Thousands)	
	9/81	9/83	9/84
Operating Receipts			
Rental Income	$ 60.14	$ 101.00 (+67.9%)	$ 130.52 (+117%)
Operating Expenditures			
Administration	17.48	6.34 (-63.7%)	6.94 (-60.3%)
Utilities (Labor)	6.19	7.77 (+26%)	8.40 (+35.7%)
Ordinary Maintenance	74.31	54.73 (-26.3%)	59.69 (-19.7%)
Non-routine Maintenance	0	2.26	---

services designed to facilitate participation in the labor force. The resident council operates training programs for 80 adults and youth at Kenilworth, and a post-secondary assistance program which has sent 480 youth to colleges and technical/vocational schools. The Resident Management Corporation has created 120 jobs through 6 new businesses and 2 joint ventures with private firms.

The heightened responsibility of the residents has increased their participation in all of these self-improvement services and enterprises. This, in turn, increases their earnings and provides adequate rental income and consumer spending power to manage the units and support the new businesses. Referring to Table 2 "Resident Income," overall resident income from all sources has increased by 26 percent from $2,287,000 to $2,548,000. More importantly, while overall income is rising, the increase is due to more income from work and less from welfare. Income from work increased by 27 percent from $1,016,000 to $1,287,000 over the 2½ years that the KPRMC has been operating. Income from welfare has dropped 28 percent during the same period from $904,000 to $650,000. One-quarter of the 353 families we studied have left welfare entirely, and families that are totally dependent have decreased by 50 percent. With more residents going to work and less dependent on welfare the incomes of the families will continue to rise. Please note that there are still impoverished families at Kenilworth. In Table 3 "Tenant Rents," one-third of the families pay $100 or less for rent per month, and 6 percent pay under $50. The revenue success at Kenilworth is due to both rising family incomes and everyone, without regard to level of income, faithfully paying their rents.

TABLE 2

RESIDENT INCOME (All Sources)
(Thousands)

	Total	(Mean income)
1981	2,287	(7,624)
1982	2,605	(8,272)
1983	2,727	(8,045)
1984	2,312	(8,660)

	Sources (Thousands)			
	Work	(mean)	Public Welfare	(mean)
1981	1,016	(8,470)	904	(4,323)
1982	1,171	(8,675)	894	(4,341)
1983	1,429	(9,593)	828	(4,080)
1984	1,262	(10,265)	650	(4,041)

TABLE 3

TENANT RENTS

Hi = 512
Lo = 6
Monthly = 68,609.50

1 - 10 = 2 (1,1)	.0043 = .4%		
11 - 50 = 27 (3, 3, 1, 6, 14)	.0590 = 5.9%		
51 - 100 = 153 (25, 12, 9, 49, 58)	.3347 = 33.5%		
101 - 200 = 138 (9, 18, 29, 32, 50)	.3019 = 30.2%		
201 - 250 = 47 (3, 6, 10, 11, 17)	.1028 = 10.3%	30%	
251 - 300 = 35 (1, 8, 6, 13, 7)	.0765 = 7.7%	19.7%	
301 - 350 = 33 (0, 3, 9, 9, 12)	.0722 = 7.2%	12%	
351 - 400 = 14 (2, 2, 2, 6, 2)	.0306 = 3.1%		
401 - 450 = 5 (0, 0, 2, 3, 0)	.0109 = 1.1%		
451 - 500 = 2 (0, 0, 1, 0, 1)	.0043 = .4%		
501 - + = 1 (0, 1, 0, 0, 0)	.0021 = .2%		
457 units	100%		

6.3% $50 and under
33.5% 51 - 100
30.2% 101 - 200
30% over 200
19.7% over 250
12% over 300
4.8% over 350

Third, the Kenilworth model combines services and jobs with effective management procedures into an effective blend of sanctions and incentives. Neither sanctions nor incentives alone, in my opinion, are sufficient strategies for improving the conditions and management of public housing. Sanctions such as fines for destroying property, replacing appliances damaged by resident negligence with used rather than new appliances and the community peer court to resolve disputes and impose fines are powerful tools to shape attitudes and behaviors. Incentives such as jobs and the opportunity to start your own business with financial support from the KPRMC are equally powerful.

Fourth and finally, the KPRMC manages the units responsibly. They rigorously adhere to maintenance schedules, and the rent collection and income verification procedures are consistent and thorough. As Mrs. Kimi Gray, Chairman of the Resident Council, noted "Since the management staff live at Kenilworth--when the heat and hot water are off for the residents--they are off for the managers too. And the first rents we check to see if they were paid on time are the rents from the management staff and board members." There are no incentives for the management staff to cut corners.

Based on the experience at Kenilworth, I recommend that:

1. Resident involvement be made a standard feature of any models for privatizing the management of public housing. Preferably, residents should be involved through an elected resident council and a separate resident management corporation. The corporation could manage the property--after

proper training--on its own or in equity partnership with a private property management firm.

2. Modernization funds should be used to upgrade properties before a private sector organization is given responsibility for management.
3. Congress should work closely with HUD on the homeownership initiative. HUD, through the Public Housing Homeownership Demonstration, is approaching this effort very appropriately. The HUD design will allow everyone to learn from the demonstration and refine the process. Congress should be hesitant to charge too far ahead of the demonstration.
4. Homeownership should be viewed as a major incentive for low-income families in public housing and distressed neighborhoods. Part of the economic success of Kenilworth was due to residents paying their rents on time to qualify for 20 town houses which KPRMC envisions building for the most responsible residents.
5. Caution should be exercised in the selection of private firms. Remember the deplorable conditions at Kenilworth were the responsibility of government agencies and a private contractor. In my opinion, without the involvement of residents in the ways that I have described, no arrangement, public or private, will accomplish the goal of improving the management of public housing.

Thank you.

Senator SYMMS. Thank you very, very much for your testimony.

Mr. WILSON. Thank you for having me.

Senator SYMMS. Thank you very much, Mr. Wilson. We appreciate it.

I'd like to thank both witnesses that made this hearing a success this morning.

The subcommittee will now stand adjourned.

[Whereupon, at 10:40 a.m., the subcommittee adjourned, subject to the call of the Chair.]

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